The Corporate Governance Machine

Law Working Paper N° 564/2021
February 2021

Dorothy S. Lund
University of Southern California

Elizabeth Pollman
University of Pennsylvania and ECGI

ECGI Working Paper Series in Law

The Corporate Governance Machine

Working Paper N° 564/2021
February 2021

Dorothy S. Lund
Elizabeth Pollman

We thank Steve Bainbridge, Bill Bratton, Christopher Bruner, Dick Buxbaum, Mike Dorff, Jill Fisch, Don Herzog, Virginia Harper Ho, Nico Howson, Stavros Gadinis, Linda Lin, Ann Lipton, Amelia Miazad, Peter Molk, Mariana Pargendler, Bob Rasmussen, Rob Rhee, Sergio Gramitto Ricci, Danny Sokol, Steven Davidoff Solomon, Leo E. Strine, Jr., Anne Tucker, Cindy Williams, Andrew Winden, and workshop participants at the Organizations and Social Impact Workshop at Berkeley Law, Foundations of Law and Finance Research Seminar at Goethe University-Frankfurt, Corporate and Securities Law in Society Workshop, University of Florida Levin College of Law, Fordham University School of Law, and University of Richmond School of Law. We also thank Hayk Badalyan and QC Vu for excellent research assistance.

Abstract

The conventional view of corporate governance is that it is a neutral set of processes and practices that govern how a company is managed. We demonstrate that this view is profoundly mistaken: in the United States, corporate governance has become a "system" composed of an array of institutional players, with a powerful shareholderist orientation. Our original account of this "corporate governance machine" generates insights about the past, present, and future of corporate governance. As for the past, we show how the concept of corporate governance developed alongside the shareholder primacy movement. This relationship is reflected in the common refrain of "good governance" that pervades contemporary discourse and the maturation of corporate governance as an industry oriented toward serving shareholders and their interests. As for the present, our analysis explains why the corporate social responsibility movement transformed into shareholder value-oriented ESG, stakeholder capitalism became relegated to a new separate form of entity known as the benefit corporation, and public company boards of directors became homogenized across industries. As for the future, our analysis suggests that absent a major paradigm shift, advocacy pushing corporations to consider the interests of employees, communities, and the environment will likely fail if such effort is not framed as advancing shareholder interests.

Keywords: corporate governance, corporations, corporate purpose, shareholder primacy, stakeholder governance, ESG, environmental, social, CSR, corporate social responsibility, benefit corporations, boards of directors, independent directors, dual-class stock, corporate governance innovation

JEL Classifications: D21, D23, D82, G30, G34, K22, L21, L22

Dorothy S. Lund
Assistant Professor of Law
University of Southern California, Gould School of Law
699 Exposition Blvd
Los Angeles, CA 90089, United States
phone: +1 847 334 2262
e-mail: dlund@law.usc.edu

Elizabeth Pollman*
Professor of Law
University of Pennsylvania, Carey Law School
and Institute for Law and Economics
3501 Sansom Street
Philadelphia , PA 19104, United States
phone: +1 215 898 4564
e-mail: elizabeth.pollman@law.upenn.ed

*Corresponding Author

University of Pennsylvania Carey Law School

ILE

INSTITUTE FOR LAW AND ECONOMICS

A Joint Research Center of the Law School, the Wharton School,
and the Department of Economics in the School of Arts and Sciences
at the University of Pennsylvania

RESEARCH PAPER NO. 21-05

The Corporate Governance Machine

Dorothy S. Lund
UNIVERSITY OF SOUTHERN CALIFORNIA GOULD SCHOOL OF LAW

Elizabeth Pollman
UNIVERSITY OF PENNSYLVANIA CAREY LAW SCHOOL

THE CORPORATE GOVERNANCE MACHINE

Dorothy S. Lund* & Elizabeth Pollman**

The conventional view of corporate governance is that it is a neutral set of processes and practices that govern how a company is managed. We demonstrate that this view is profoundly mistaken: in the United States, corporate governance has become a "system" composed of an array of institutional players, with a powerful shareholderist orientation. Our original account of this "corporate governance machine" generates insights about the past, present, and future of corporate governance. As for the past, we show how the concept of corporate governance developed alongside the shareholder primacy movement. This relationship is reflected in the common refrain of "good governance" that pervades contemporary discourse and the maturation of corporate governance as an industry oriented toward serving shareholders and their interests. As for the present, our analysis explains why the corporate social responsibility movement transformed into shareholder value-oriented ESG, stakeholder capitalism became relegated to a new separate form of entity known as the benefit corporation, and public company boards of directors became homogenized across industries. As for the future, our analysis suggests that absent a major paradigm shift, advocacy pushing corporations to consider the interests of employees, communities, and the environment will likely fail if such effort is not framed as advancing shareholder interests.

* Assistant Professor of Law, USC Gould School of Law.

** Professor of Law, University of Pennsylvania Law School. We thank Steve Bainbridge, Bill Bratton, Christopher Bruner, Dick Buxbaum, Mike Dorff, Jill Fisch, Don Herzog, Virginia Harper Ho, Nico Howson, Stavros Gadinis, Linda Lin, Ann Lipton, Amelia Miazad, Peter Molk, Mariana Pargendler, Bob Rasmussen, Rob Rhee, Sergio Gramitto Ricci, Danny Sokol, Steven Davidoff Solomon, Leo E. Strine, Jr., Anne Tucker, Cindy Williams, Andrew Winden, and workshop participants at the Organizations and Social Impact Workshop at Berkeley Law, Foundations of Law and Finance Research Seminar at Goethe University-Frankfurt, Corporate and Securities Law in Society Workshop, University of Florida Levin College of Law, Fordham University School of Law, and University of Richmond School of Law. We also thank Hayk Badalyan and QC Vu for excellent research assistance.

THE CORPORATE GOVERNANCE MACHINE

Dorothy S. Lund & Elizabeth Pollman

INTRODUCTION

In a time of climate change, racial and economic inequality, and crisis stemming from the global pandemic, corporations are alternately maligned for their conduct and embraced as a solution for change. Observers have increasingly excoriated the traditional view of corporate purpose—that corporations should be managed for the benefit of shareholders, and specifically, to maximize their wealth—as contributing to societal problems.[1] Politicians from the right and left have begun to attack "shareholder primacy" as contributing to wage stagnation and slow economic growth.[2] And, as the Covid-19 pandemic wages on, many have blamed this corporate objective for a wide range of profit-squeezing behavior such as firing employees while simultaneously declaring shareholder dividends.[3] Spurred by this debate, and only two decades after prominent scholars announced "the end of history" in favor of shareholder primacy,[4] luminaries in the field are again asking these central questions of corporate law: For whom is the corporation managed?[5] Do fiduciaries owe a duty to maximize shareholder value or may they prioritize the interests of other stakeholders?

This Article contributes to this important debate by enlarging the aperture. Specifically, it provides an original descriptive account of the "corporate governance machine"—a complex governance system in the United States composed of law, markets, and culture that orients corporate decisionmaking toward shareholders. It describes the key players in the system and shows how the machine powerfully drives corporate behavior and also dictates the form of corporate regulation.

---

[1] *See, e.g.*, COLIN MAYER, PROSPERITY (2018) (arguing that shareholder wealth maximization is a fundamentally flawed understanding of corporate purpose).

[2] Accountable Capitalism Act, S. 3348, 115th Cong. (2018) (sponsored by Senator Elizabeth Warren); MARCO RUBIO, AMERICAN INVESTMENT IN THE 21ST CENTURY: PROJECT FOR STRONG LABOR MARKETS AND NATIONAL DEVELOPMENT 4, 22–34 (2019).

[3] *See, e.g.*, Leo E. Strine, Jr. & Dorothy S. Lund, *How Business Should Change After the Coronavirus Crisis*, N.Y. TIMES (Apr. 10, 2020), https://www.nytimes.com/2020/04/10/business/dealbook/coronavirus-corporate-governance.html; Martin Whittaker, *Is COVID-19 Killing Shareholder Primacy?*, FORBES (Apr. 9, 2020, 9:37 AM), https://www.forbes.com/sites/martinwhittaker/2020/04/09/is-covid-19-killing-shareholder-primacy/#15a48c0e5661; Tim Wu, *The Virtuous Corporation Is Not an Oxymoron*, N.Y. TIMES (Sept. 23, 2019), https://www.nytimes.com/2019/09/23/opinion/stakeholder-capitalism.html.

[4] Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 471–72 (2001). Scholars have used the term "shareholder primacy" to refer to two different concepts, reflecting the ends and means or purpose and power of corporations: (1) that corporations are, or should be, managed in the interests of shareholders; and (2) that shareholders have, or should have, ultimate control over the corporation. Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 573 (2003); Robert B. Thompson, *Anti-Primacy: Sharing Power in American Corporations*, 71 BUS. LAW. 381, 387–88 (2016). We primarily use the term descriptively in the first sense.

[5] Lucian A. Bebchuk & Roberto Tallarita, *The Illusory Promise of Stakeholder Governance*, 105 CORNELL L. REV. (forthcoming 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3544978; Jill E. Fisch & Steven Davidoff Solomon, *Should Corporations Have a Purpose?* (ECGI L., Working Paper No. 510/2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3561164; Edward B. Rock, *For Whom Is the Corporation Managed in 2020?: The Debate over Corporate Purpose* (ECGI L., Working Paper No. 515/2020), https://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=44766.

In so doing, the Article makes three primary contributions. For one, we provide the first holistic account of the contemporary U.S. corporate governance infrastructure and show how it solidifies corporate purpose as promoting shareholder interests. Although legal academics have generally focused on corporate law as a key determinant of purpose, our analysis reveals that this element may well be the least important: a vast array of institutional players—proxy advisors, stock exchanges, ratings agencies, institutional investors and associations—enshrine shareholder primacy in public markets. Indeed, we show the very concept of corporate governance promoted by these players developed alongside the principal-agent model of the corporation, such that "good governance" is often equated with minimizing agency costs in the pursuit of shareholder value. Professional education, the media, and politics further reinforce this cultural understanding.

We also explore examples that demonstrate the machine's influence over all aspects of public company governance. Corporate social responsibility, for example, was once framed in moral terms as a goal for management irrespective of profit.[6] But after several decades of circulation within the machine, the idea of corporate social responsibility has been largely replaced with investor-driven ESG. Today many companies pursue "environmental, social, and governance" goals, and investors favor ESG funds, not for moral reasons or a prosocial willingness to sacrifice profits, but because ESG is thought to provide sustainable long-term value or higher risk-adjusted returns for shareholders.[7] This reframing has in turn shaped managerial decisionmaking about the kinds of ESG activity in which corporations should engage. As the corporate governance machine transformed corporate social responsibility into value-enhancing ESG, it has also pushed social purpose beyond this framing into an entirely different form of corporation—the benefit corporation—which we show is also driven by shareholders and their values.

Second, we look to the consequences of the corporate governance machine's workings and posit that its shareholderist orientation is potentially suboptimal. We argue that when shareholderism is locked in to rules, norms, and power structures, superior governance arrangements from a social welfare perspective may be discouraged or taken off the table.[8] From convergence on one-size-fits all governance "best practices" to reduced corporate governance innovation, we identify a range of negative implications for corporate law and governance wrought by this system.

Third, and finally, our "meta" account of the U.S. corporate governance system elucidates much about the path of corporate governance reform, and the success of the stakeholder governance movement in particular. At the outset, we show how over the past several decades, law, markets, and culture have entrenched a shareholder-oriented view in corporate law and governance. Battles over the allocation of power within the corporation occur on policy issues such

---

[6] *See infra* Section I.B.

[7] *See infra* notes 206–215 and accompanying discussion.

[8] The resulting diversity in governance might fall short of the expectations of contractarian scholars as well as those who recognize that network benefits can accrue from common use and advocate for a menu approach to corporate law. *See* FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 5, 34 (1996) (stating that "[n]o set of promises is right for all firms" and arguing that corporate law's purpose is to provide efficient default rules that can be customized); Michael Klausner, *The Contractarian Theory of Corporate Law: A Generation Later*, 31 J. CORP. L. 779 (2006) (discussing how "[c]orporate law can . . . promote innovation and customization by providing menus of alternative governance structures that firms can adopt in standardized form by designating in their charters that they choose to do so").

as proxy access and shareholder proposals, but the larger war has been won. We predict that legal reform and soft law standards will continue to be filtered through this lens, and stakeholder-oriented reforms that are framed as benefitting shareholders will have a chance of survival. As evidence, recall that the ESG movement took off because it was viewed as consistent with shareholder value. Consider too, the evolution in corporate purpose away from share price maximization and toward "long-term shareholder value" or even "shareholder welfare" maximization.[9] In many ways, these developments soften the hard edges of shareholder primacy, but this evolution is itself a legacy of the corporate governance machine: those who wish to change corporate decision-making are forced to do so within the bounds of shareholderism.

What does this mean for the future of corporate governance? On the one hand, absent a large shock to the system such as a major federal intervention,[10] the corporate governance machine will likely impede a true paradigm shift away from shareholderism and toward stakeholderism. On the other, our account reveals how incremental change could take place. As shifts in understanding regarding the merits of various ESG initiatives occur through cultural and market forces, the promotion of stakeholder interests can be reconciled with pursuing long-term shareholder value. For example, institutional investors and asset managers that hold diversified portfolios increasingly recognize the financial benefits of mitigating climate change risk.[11] Likewise, corporate sustainability initiatives can protect undiversified investors against downside risk.[12] To the extent that ESG metrics become easier to measure and disclose, more of such activity might occur and a greater number of investors might support it. Notably, however, this future change is likely to occur through the existing shareholderist model, which limits acceptable rationales and favors activity that can be reduced to measurable metrics tied to risk or financial value.[13]

Our paper proceeds as follows. Part I traces the historical and intellectual underpinnings of corporate governance and charts its rise alongside the shareholder primacy movement. Part II

---

[9] *See* Jesse M. Fried, *The Uneasy Case for Favoring Long-Term Shareholders*, 124 YALE L.J. 1554, 1565 (2015) (observing "as a matter of economic theory, the effect of manager time horizons (that is whether managers serve short-term or long-term shareholders) on stakeholder welfare is actually indeterminate"); Frank Partnoy, *Specificity and Time Horizons*, 41 SEATTLE U. L. REV. 525, 533 (2018) (arguing that stakeholder advocates should articulate an optimal time horizon for firm managers to use and bases for such a conclusion); *see also* Virginia Harper Ho, *"Enlightened Shareholder Value": Corporate Governance Beyond the Shareholder-Stakeholder Divide*, 36 J. CORP. L. 59, 74–75 (2010) (discussing aspects of corporate law that "permit decision-makers to preference stakeholder interests over shareholder wealth maximization"); Ann M. Lipton, *What We Talk About When We Talk About Shareholder Primacy*, 69 CASE W. RES. L. REV. 863, 866–67 (2019) (discussing how most scholarly discourse equates shareholder primacy with wealth maximization but recent literature has described it in terms of welfare or values that shareholders can privately determine for themselves).

[10] Although the Covid-19 pandemic could prove a catalyst, the emerging consensus is that it will not result in sweeping change to corporate and securities law. *See, e.g.*, Brian Cheffins & Steven Bank, *Corporate Law's Critical Junctures* (unpublished manuscript) (on file with authors).

[11] Madison Condon, *Externalities and the Common Owner*, 95 WASH. L. REV. 1 (2020); Jeffrey N. Gordon, *Systematic Stewardship* (ECGI L., Working Paper, 2020).

[12] Stavros Gadinis & Amelia Miazad, *Corporate Law & Social Risk*, 73 VAND. L. REV. 1401 (2020); Leo E. Strine, Jr., Kirby Smith & Reilly Steel, Caremark *and ESG, Perfect Together: A Practical Approach to Implementing an Integrated, Efficient, and Effective* Caremark *and ESG Strategy*, IOWA L. REV. (forthcoming 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3664021.

[13] An even greater incorporation of stakeholder interests could occur if shareholders were understood to be individuals with diverse preferences. *See* Oliver Hart & Luigi Zingales, *Companies Should Maximize Shareholder Welfare Not Market Value*, 2 J. L. FIN. & ACC. 247 (2017). Such an approach would require developing improved means to aggregate shareholder preferences.

provides an original descriptive account of the U.S. system of corporate governance and its components, showing how law, markets, and culture enmesh shareholderism at public corporations. Part III explores how the corporate governance machine works using three examples. It describes how the machine has transformed public company boards, shaped the shift from corporate social responsibility to investor-driven ESG, and led to the development of a new form of business organization—the benefit corporation. Part IV examines the broader implications of our analysis for the debate about corporate purpose and other pressing debates in corporate law, and concludes with predictions about the future of corporate governance.

I. THE CONCURRENT RISE OF CORPORATE GOVERNANCE AND SHAREHOLDER PRIMACY

We begin by tracing the coinage of the term "corporate governance" and the context of its conception, and then we chart its rise alongside the widespread adoption of shareholder primacy. In so doing, we lay the historical foundation for understanding the law, markets, and culture that make up the modern corporate governance machine. We observe a connection between the term corporate governance as it became used in the 1970s and the rise of the shareholder primacy movement that became the dominant paradigm. This relationship is reflected in the common refrain of "good governance" that pervades contemporary discourse and the maturation of corporate governance as an industry, oriented toward serving shareholders and their interests.

A. The Path to Corporate Governance

To start, we acknowledge that as long as the corporate form has existed, issues of corporate governance have emerged, although observers at the time did not refer to the issues in those terms. Legal historians commonly pinpoint the 1920s and 30s as the foundational era for early debates.[14] The industrial developments leading up to this time had transformed the economic landscape. The great merger movement at the turn of the twentieth century generated large-scale enterprises and, in turn, created a large number of small shareholders who fueled the growth of the New York Stock Exchange.[15] By the 1920s, millions of Americans became first-time investors.[16]

Amidst this growth in the shareholder class, as well as economic and regulatory upheaval,[17] Adolf Berle and Gardiner Means published their 1932 landmark book, *The Modern Corporation and*

[14] *See, e.g.*, Harwell Wells, *The Birth of Corporate Governance*, 33 SEATTLE U. L. REV. 1247, 1247–49 (2010).
[15] *See id.* at 1253–54; NAOMI LAMOREAUX, THE GREAT MERGER MOVEMENT IN AMERICAN BUSINESS, 1895-1904 (1985); ALFRED D. CHANDLER, THE VISIBLE HAND: THE MANAGERIAL REVOLUTION IN AMERICAN BUSINESS 340–44 (1977); Mary O'Sullivan, *The Expansion of the U.S. Stock Market, 1885-1930: Historical Facts and Theoretical Fashions*, 8 ENTER. & SOC'Y 489, 489 (2007).
[16] *See* Julia Cathleen Ott, *When Wall Street Met Main Street: The Quest for an Investors' Democracy and the Emergence of the Retail Investor in the United States, 1890-1930*, 9 ENTER. & SOC'Y 619, 620 (2008) (estimating the percentage of U.S. households owning stock went from approximately 3 to 25 percent in the early 1900s). The trend accelerated during World War I with great numbers of Americans buying Liberty Bonds to help fund the war. DAVID M. KENNEDY, OVER HERE: THE FIRST WORLD WAR AND AMERICAN SOCIETY 105–06 (1980); *see also* Wells, *supra* note 14, at 1265.
[17] For example, after the stock market crash of 1929 and during the ensuing Great Depression, Congress successively passed the Securities Act of 1933 and the Exchange Act of 1934, creating a framework of federal securities regulation based on a philosophy of disclosure and establishing the Securities and Exchange Commission (SEC) "to enforce the newly-passed securities laws, to promote stability in the markets and, most importantly, to protect investors." SEC, *What We Do*, https://www.sec.gov/Article/whatwedo.html#create (June 10, 2013); LOUIS LOSS, JOEL SELIGMAN & TROY PAREDES, SECURITIES REGULATION 254–57, 300–05 (4th ed. 2006).

Private Property.[18] Building on earlier thinkers, Berle and Means documented the rise of large corporations with dispersed stock and the weakening of shareholder control.[19] But instead of concluding the solution was to reestablish shareholder power as it had existed before the rise of giant industrial companies, they highlighted that the transformation of American capitalism called for a more profound rethinking of "the ends for which the modern corporation can or will be run."[20] The work was an instant classic—orienting corporate law and theory around the issue of the separation of ownership and control, but without elevating the importance of shareholders in the balance.[21]

Berle and Means' vision of corporate managers as socially responsive trustees came to fruition as the economy recovered after World War II.[22] By the mid-twentieth century, "managerial capitalism" reached its zenith, in which "neither boards nor shareholders acted as a robust check on potentially wayward executives."[23] Stock ownership was widely dispersed and shareholders lacked the incentive, information, and expertise to exercise voice or provide oversight.[24] Boards dominated by full-time insiders led the nominating process to re-elect themselves and fill the remaining seats.[25] Managers were instead checked by what economist John Kenneth Galbraith termed "countervailing power."[26] This force consisted of "industry-level regulation, robust antitrust enforcement, fears of additional heavy-handed government intrusions, powerful unions, and a banking sector reluctant to back risky corporate ventures."[27] Further, corporate managers, "mindful of intense criticism of business in the Depression, took pains to emphasize the good citizenship of the firms they ran."[28] It was during this period that the term "corporate governance" first arose—by a business ethicist advocating for the notion of a "well-tempered corporation" and calling for "a theory corporate governance consistent with the ideals of a democratic society."[29]

---

18 ADOLF A. BERLE, JR. & GARDINER MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1932).

19 Wells, *supra* note 14, at 1289; HERBERT HOVENKAMP, ENTERPRISE AND AMERICAN LAW: 1836-1937 16, 357 (1991); *see also* Walter Werner, *Corporation Law in Search of its Future*, 81 COLUM. L. REV. 1611, 1612 (1981) (discussing the separation of ownership and control as a longstanding feature of American corporations).

20 BERLE & MEANS, *supra* note 18, at 7–8.

21 *See* William W. Bratton & Michael L. Wachter, *Shareholder Primacy's Corporatist Origins: Adolf Berle and The Modern Corporation*, 34 J. CORP. L. 99, 120 (2008) (discussing the work's suggestion that the separation of ownership and control might reflect a "transformation of corporate profits from purely private property to property touched with a public interest"); JAMES P. HAWLEY & ANDREW T. WILLIAMS, THE RISE OF FIDUCIARY CAPITALISM: HOW INSTITUTIONAL INVESTORS CAN MAKE CORPORATE AMERICA MORE DEMOCRATIC 42 (2000) ("The phenomenon Berle and Means identified in 1932—the divorce of ownership and control—would come to dominate most thinking about issues of corporate governance for the rest of the twentieth century.").

22 *See* CHANDLER, *supra* note 15, at 14 ("By the 1950s, full-time salaried managers, with little equity in the enterprises they operated, were making nearly all operating and strategic decisions.").

23 BRIAN R. CHEFFINS, THE PUBLIC COMPANY TRANSFORMED 37 (2019).

24 *See, e.g.*, J.A. LIVINGSTON, THE AMERICAN STOCKHOLDER 81 (1958) (noting shareholders were "known for their indifference to everything about the companies they own except dividends and the approximate price of the stock").

25 CHEFFINS, *supra* note 23, at 40; *see also* PETER DRUCKER, THE PRACTICE OF MANAGEMENT 154 (1955).

26 JOHN KENNETH GALBRAITH, AMERICAN CAPITALISM: THE CONCEPT OF COUNTERVAILING POWER (rev. ed. 1956).

27 CHEFFINS, *supra* note 23, at 37.

28 Letter from Larry Kramer, President, Hewlett Found., to the Board of Directors, Hewlett Found. 8 (Apr. 26, 2018), https://hewlett.org/library/beyond-neoliberalism-rethinking-political-economy/; Peter F. Drucker, *The Responsibilities of Management*, HARPER'S, Nov. 1954, 67 (observing a "trend among managers to think of themselves almost as public servants, not men driven by a ruthless craving for profits").

29 *See* RICHARD EELLS, THE MEANING OF MODERN BUSINESS 52, 336 (1960); RICHARD EELLS, THE GOVERNMENT OF CORPORATIONS vii (1962) ("I have tried to emphasize, in this first general treatment of the subject of corporate governance, the importance of constitutionalism as applied to business polities."); *see also* Bernard Mees, *Corporate*

B. The Birth of Two Concepts

The 1970s mark the key inflection point that started to turn the tide away from managerial capitalism and set in motion our contemporary system.[30] Early in this trajectory came the spread of the term "corporate governance" beyond its academic origins—it first appeared in the *New York Times* in 1972,[31] and within a few years also appeared in the Federal Register.[32] It was no coincidence that this new term came into common usage during the 1970s. One of the great U.S. public companies, Penn Central, collapsed with revelations of commercial bribery, resulting at the time in the "single largest bankruptcy in [the] nation's history."[33] Moreover, around the same time, it came to light that over 350 public corporations had engaged in illicit payments.[34] For years, "the business pages of American newspapers [carried] a continuing story of corporate misconduct," and the public grew disillusioned with big business.[35] The stock market was producing dismal returns, leading a major business publication to report "The Death of Equities."[36]

Stemming from an analogy between the government and the corporation, corporate governance expressed the notion that limitations on corporate power or misconduct could come through internal constraints.[37] Public-interest activist, Ralph Nader, for example, argued that "if corporate governance is to be reformed, it must begin by returning the board to [its] historical role" as "an internal auditor of the corporation, responsible for constraining executive management from violations of law and breach of trust."[38] Likening the board to "a rival branch of government," he argued this reform was necessary because the "autocratic power" of executives "led to recurring violations of law, conflicts of interest, productive inefficiency, and pervasive harm to consumers, workers, and the community environment."[39] For different reasons, both the political left and right embraced this analogy of controlling managerial power through internal government-like checks and balances.[40]

Notably, this early usage of corporate governance captured the division or balance of power among a particular set of participants—the board of directors, executives, and shareholders. At

Governance as a Reform Movement, 21 J. MGMT. HIST. 194 (2015) (attributing the origins of the term corporate governance to Eells); Mariana Pargendler, *The Corporate Governance Obsession*, 42 J. CORP. L. 359, n.69 (2016) (same).

30 *See* CHEFFINS, *supra* note 23, at 101–02 (observing "the 1970s provided the platform for change, an inflection point for the postwar industrial system") (internal quotation omitted); Lynn A. Stout, *On the Rise of Shareholder Primacy, Signs of Its Fall, and the Return of Managerialism (in the Closet)*, 36 SEATTLE U. L. REV. 1169, 1172 (2013) [hereinafter Stout, *Rise of Shareholder Primacy*] (noting managerial capitalism ran "into headwinds" by the early 1970s).

31 Pargendler, *supra* note 29, at 373.

32 *Id.*

33 Staff Report of the SEC to the Special Subcommittee on Investigations, The Financial Collapse of The Penn Central Company iii (Aug. 1972), https://fraser.stlouisfed.org/files/docs/historical/house/1972house_fincolpenncentral.pdf; CHEFFINS, *supra* note 23, at 37.

34 John C. Coffee, Jr., *Beyond the Shut-Eyed Sentry: Toward a Theoretical View of Corporate Misconduct and an Effective Legal Response,* 63 VA. L. REV. 1099, 1102–03 (1977).

35 *Id.* at 1101; CHEFFINS, *supra* note 23, at 105.

36 CHEFFINS, *supra* note 23, at 104–05 (citing Barry Ritholtz, *The Death of Equities*, BUSWK. (Aug. 13, 1979)).

37 EELLS, *supra* note 29, at 184–210; Pargendler, *supra* note 29, at 374.

38 RALPH NADER, MARK GREEN & JOEL SELIGMAN, TAMING THE GIANT CORPORATION 119 (1976).

39 *Id.* at 122.

40 Pargendler, *supra* note 29, at 375; William W. Bratton, *The Separation of Corporate Law and Social Welfare*, 74 WASH. & LEE L. REV. 767, 775–77 (2017); *see also* NADER ET AL., *supra* note 38, at 8–9 (arguing that the "private governments of the megacorporations" should be made more democratic and responsive to "public needs"); ROBERT HESSEN, IN DEFENSE OF THE CORPORATION (1979) (presenting a neoclassical view of corporate governance).

first this discourse simply reflected the "received legal model of the corporation" and the era of managerial capitalism that was at its end.[41] For example, in 1976, corporate law scholar Melvin Eisenberg published a widely-cited book setting out the legal structure under which "the board of directors manages the corporation's business and makes policy; the officers act as agents of the board and executive its decisions; and the shareholders elect the board. . . ."[42] Without using the term "corporate governance," he critically observed that in practice, managerial power was vested in the executives and that shareholder voting was an empty formality.[43] He advocated for boards to serve a strong monitoring role.[44] The same year, economist Michael Jensen and business school dean William Meckling injected the economic concept of agency costs into debate about corporations.[45] Jensen and Meckling asserted that "the relationship between the stockholders and manager of a corporation fit the definition of a pure agency relationship."[46] In this vision, the divergence of interests between the shareholders and corporate managers became "agency costs" to be minimized.[47] The corporation itself disappeared as a mere "legal fiction" and "nexus" for contracting.[48] In all, the principal-agent model provided the simple, sticky idea that had been lacking—"a workable model of how a corporation behaves internally."[49]

A normative overlay of what constitutes "good" corporate governance swiftly emerged and came to predominate debates in law and business.[50] Scholars imported economic concepts into corporate law and added a normative lens, mixing the term corporate governance with the principal-agent model. In 1982, for example, Daniel Fischel wrote in *The Corporate Governance Movement*: "As residual claimants on the firm's income stream, shareholders want their agents—the firm's managers—to maximize wealth."[51] Fischel suggested that corporate law, contracting, and markets provided the necessary governance mechanisms to respond to the agency costs "inherent" in the corporate form.[52] Corporations could hire directors as "monitors" and "managerial contracts can provide managers with incentives to maximize shareholders' welfare," such as by tying manager's compensation to the company's share price.[53] According to this theory, focusing management attention on shareholder wealth would best maximize corporate value, and also social welfare, as other bodies of law could regulate corporate externalities that would harm the public.[54]

---

[41] *See* MELVIN ARON EISENBERG, THE STRUCTURE OF THE CORPORATION: A LEGAL ANALYSIS 1 (1976).
[42] *Id.* at 1.
[43] *Id.* at 97–104, 139–41.
[44] *Id.*; *see infra* Section III.A.
[45] *See generally* Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976); *see also* Stout, *Rise of Shareholder Primacy*, *supra* note 30, at 1173 (describing how "managerial capitalism fell into academic disrepute" in "the decades following the publication of Jensen and Meckling's article" and was replaced with "shareholder primacy"); Bratton, *supra* note 40, at 777 (observing that the terms "agency costs" and "corporate governance" came into usage "in tandem").
[46] Jensen & Meckling, *supra* note 45, at 309.
[47] *Id.*
[48] *See id.* at 308.
[49] *See* Coffee, *supra* note 34, at 1109–10 (noting in a 1977 article the lack of such a workable model and how "corporate practitioners and legal academicians tend to view the corporation as a 'black box'").
[50] *See* CHEFFINS, *supra* note 23, at 5 ("Under the mantle of better 'corporate governance,' a term rarely used before the mid-1970s, 'internal' constraints had been strengthened since the heyday of managerial capitalism.").
[51] Daniel Fischel, *The Corporate Governance Movement*, 35 VAND. L. REV. 1259, 1262 (1982) (citing Jensen & Meckling, *supra* note 45).
[52] *Id.*
[53] *Id.* at 1263.
[54] *See* Frank Easterbrook & Daniel Fischel, *The Corporate Contract*, 89 COLUM. L. REV. 1416, 1436 (1989).

In sum, while at the start of the 1970s the term corporate governance had initially connoted "a political structure to be governed,"[55] embraced by those "taming the giant corporation" in the public interest,[56] by the early 1980s, louder voices had started to prevail in focusing the term's meaning on reducing agency costs to serve shareholder interests. Corporate governance underwent a "revolution" toward the "monitoring model."[57] Further, scholars began to embrace characterizations of corporate social responsibility as an ill-conceived basis for business regulation or management.[58] Milton Friedman's view—that the corporation "has only one social responsibility . . . to increase its profit so long as it stays within the rules of the game"[59]—gained adherents.

C. The Reign of Shareholder Primacy and Good Governance

The birth of corporate governance and its linkage with shareholder primacy became the dominant mode of discourse in the decades that followed. During the Deal Decade of the 1980s, terminology and concepts that might have remained in a dusty corner of the ivory tower were instead thrust into the limelight as a record number of unsolicited tender offers became proof of a "market for corporate control" and sharpened managers' focus on producing "shareholder value" lest they become a target.[60] Rapid growth in share ownership by institutional investors reinforced this dynamic of pressure on public company boards and executives as large shareholders expressed their enthusiasm for takeover bids.[61] In contrast to the considerable autonomy that boards and executives had enjoyed in previous times, during this period of frenzied M&A activity, management "found themselves under a novel, heavy onus to respond to shareholder preferences."[62] Blockbuster cases in Delaware courts such as *Smith v. Van Gorkom*[63] and *Revlon, Inc. v. MacAndrews & Forbes Holdings*[64] reflected the shift in thinking toward agency theory and a monitoring board that served shareholders.

A clear sign of a shifting tide away from managerial capitalism and toward shareholder primacy can be found in the ensuing debate about whether boards should consider the interests of groups other than shareholders when determining whether to defend against a hostile takeover. During this time, employees, customers, suppliers, and local communities became "stakeholders" and "constituencies."[65] Whereas earlier references had highlighted the essential support that stakeholders provided to corporations,[66] in the 1980s this terminology began to treat as "other"

---

55 Brian R. Cheffins, *The Corporate Governance Movement, Banks, and the Financial Crisis*, 16 THEO. INQ. L. 1, 6 (2015).
56 *See* NADER ET AL., *supra* note 38.
57 George W. Dent, *The Revolution in Corporate Governance, the Monitoring Board, and the Director's Duty of Care*, 61 B.U. L. REV. 623, 623 (1981).
58 Fischel, *supra* note 51, at 1268–73.
59 *See* Milton Friedman, *The Social Responsibility of Business Is to Increase Its Profits*, N.Y. TIMES MAG., Sept. 13, 1970, http://umich.edu/~thecore/doc/Friedman.pdf.
60 *See* CHEFFINS, *supra* note 23, at 151, 155–56, 162–64, 181.
61 *Id.* at 196.
62 *Id.* at 156, 212; *see also* Brian R. Cheffins, *Stop Blaming Milton Friedman!* (ECGI L., Working Paper No. 523/2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3552950 (explaining that the intellectual underpinnings from the 1970s for shareholder primacy took hold during the hostile takeover wave of the mid-1980s).
63 488 A.2d 858 (Del. 1985).
64 506 A.2d 173 (Del. 1986).
65 *See id.* at 176; Roberta Romano, *Metapolitics and Corporate Law Reform*, 36 STAN. L. REV. 923, 979 (1984).
66 R. Edward Freeman & David L. Reed, *Stockholders and Stakeholders: A New Perspective on Corporate Governance*, 25 CAL. MGMT. REV. 88, 89 (1983) (noting the term "stakeholders" originated in a 1963 Stanford Research Institute memorandum to describe "those groups without whose support the organization would cease to exist").

the corporate participants who did not hold equity.[67] At the same time, shareholders were consistently given precedence: Only two public corporations used the term "shareholder value" in annual reports before 1983, but by 1985, the number was over 50 and a majority of CEOs surveyed said that creating shareholder value was their top priority.[68]

Thus, by the end of 1980s, Berle and Means' separation of ownership and control became "the master problem"[69] and pursuing shareholder value was regularly identified as the only valid corporate objective.[70] In addition, the term "corporate governance" exploded in use, most typically in regard to corporate boards, executive performance, and shareholder involvement.[71] A congressional report aptly summarized: "While the corporate reformers of the 1970s urged that 'accountability' meant being a good corporate citizen answerable to society as a whole, observers might now suggest that 'accountability' in the 1980s means keeping stock prices high for stockholders."[72]

Furthermore, during this time, shareholder primacy came to represent more than a directive for boards and managers to serve shareholders by maximizing share price. Some proponents additionally argued that shareholders should have greater power in the corporation.[73] Shareholder primacy therefore came to encompass both the "ends" of corporate decisionmaking—*i.e.*, that the purpose of corporation is to maximize shareholder wealth—as well as the means.[74] Although the former conception gained greater adherence, in various degrees these two visions of shareholder primacy fueled the next several decades of governance reform. Boards overhauled their CEO compensation practices to "pay for performance," giving executives equity-based compensation to align their interests with shareholders.[75] Executives focused their attention on investor expectations and managing for quarterly earnings.[76] Despite the lack of conclusive empirical support, "best practices" for "good governance" spread, such as separating the roles of CEO and chairperson, eliminating staggered boards, and adopting majority voting.[77] In the twenty-first century, as hostile takeovers and the market for corporate control waned, activist shareholders emerged to push for

[67] *See, e.g.*, Lynn A. Stout, *New Thinking on "Shareholder Primacy"*, 2 ACCT. ECON. & L., no. 2, 2012, at 1, 3 ("Some commentators continued to argue valiantly for a more stakeholder-friendly view of the public corporation, but they were increasingly dismissed as sentimental, sandals-wearing leftists whose hearts outweighed their heads.").
[68] CHEFFINS, *supra* note 23, at 187.
[69] *Id.* at 186; Romano, *supra* note 65, at 923.
[70] CHEFFINS, *supra* note 23, at 186.
[71] Brian R. Cheffins, *Delaware and the Transformation of Corporate Governance*, 40 DEL. J. CORP. L. 1, 8 (2015).
[72] CHAIRMAN OF THE SUBCOMMITTEE ON TELECOMMUNICATIONS, CONSUMER PROTECTION, AND FINANCE, CORPORATE TAKEOVERS: PUBLIC POLICY IMPLICATIONS FOR THE ECONOMY AND CORPORATE GOVERNANCE 77 (1987).
[73] *See* Thompson, *supra* note 4.
[74] *See* Bainbridge, *Director Primacy*, *supra* note 4.
[75] *See* Michael C. Jensen & Kevin J. Murphy, *Performance Pay and Top-Management Incentives*, 98 J. POL. ECON. 225 (1990) (arguing for greater use of stock-based pay-for-performance structures for executive compensation to align executive incentives with maximizing shareholder value); LUCIAN BEBCHUK & JESSE FRIED, PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION (2006) (arguing that shareholders should have more power over boards and ensure that executive compensation is tied to performance through equity-based plans); Brian J. Hall, *Six Challenges in Designing Equity-Based Pay*, 15 ACCENTURE J. APPLIED CORP. FIN. 21, 23 (2003) (finding median equity-based compensation of executives at S&P 500 companies rose from 0% in 1984 to 66% in 2001).
[76] CHEFFINS, *supra* note 23, at 365.
[77] *See* David F. Larcker & Brian Tayan, *Loosey-Goosey Governance: Four Misunderstood Terms in Corporate Governance* (Stan. Closer Look Series, Research Paper No. 79, 2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3463958.

these changes under the governance mantle and often with the aim of pursuing their own profits.[78] The rise of investing through intermediaries amplified the potential for shareholder influence as stock ownership became increasingly concentrated in a small number of mutual funds and other institutions.[79]

In sum, the result of this evolution is that shareholder wealth maximization became ingrained in the very notion of "mainstream" corporate governance. Critical perspectives received labels such as "progressive corporate law" and "stakeholderism."[80] By 2001, in a provocatively titled article, *The End of History for Corporate Law*, Professors Henry Hansmann and Reinier Kraakman proclaimed that "[t]here is no longer any serious competitor to the view that corporate law should principally strive to increase long-term shareholder value."[81]

II. THE CORPORATE GOVERNANCE MACHINE

As the previous discussion illuminated, the term corporate governance was initially intended as a tool to constrain corporate power for the benefit of the public, but it subsequently developed to embody a particular view of the internal workings of the corporation, with shareholders paramount and directors and managers serving as their agents. In this Part, we describe how this intellectual legacy underpins the contemporary U.S. corporate governance system. In so doing, we provide the first holistic account of the contemporary corporate governance infrastructure in the U.S. More specifically, we describe the corporate governance machine and its three reinforcing components: law, markets, and culture.[82] We show that each element orients corporations in one direction—toward advancing shareholder interests. Although discussion of each component could fill a volume, we take a bird's-eye view to better understand the larger system in which U.S. public corporations operate.

---

[78] *See, e.g.*, William W. Bratton, *Hedge Funds and Governance Targets*, 95 GEO. L.J. 1375 (2007) (describing hedge fund activism); Marcel Kahan & Edward B. Rock, *Embattled CEOs*, 88 TEX. L. REV. 989, 995–1005 (2010) (discussing changes in shareholder composition and activism).

[79] *See* Bernard Black, *Agents Watching Agents: The Promise of Institutional Investor Voice*, 39 UCLA L. REV. 811 (1991); John Coffee, *Liquidity Versus Control: The Institutional Investor as Corporate Monitor*, 91 COLUM. L. REV. 1277 (1991); Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Reevaluation of Governance Rights*, 113 COLUM. L. REV. 863 (2013); Edward B. Rock, *Adapting to the New Shareholder-Centric Reality*, 161 U. PA. L. REV. 1907, 1922 (2013).

[80] *See, e.g.*, PROGRESSIVE CORPORATE LAW (Lawrence E. Mitchell ed., 1995); Matthew T. Bodie, *The Next Iteration of Progressive Corporate Law*, 74 WASH. & LEE L. REV. 739 (2017); KENT GREENFIELD, THE FAILURE OF CORPORATE LAW: FUNDAMENTAL FLAWS AND PROGRESSIVE POSSIBILITIES (Univ. Chicago Press 2010); Martin Gelter, *Taming or Protecting the Modern Corporation? Shareholder-Stakeholder Debates in a Modern Comparative Light*, 7 NYU J.L. & BUS. 641, 666 (2011); David Millon, *Communitarians, Contractarians, and the Crisis in Corporate Law*, 50 WASH. & LEE L. REV. 1371 (1993).

[81] Hansmann & Kraakman, *supra* note 4, at 440–41.

[82] For discussion of the definition and significance of a "system," see Tamara Belinfanti & Lynn Stout, *Contested Visions: The Value of Systems Theory for Corporate Law*, 166 U. PA. L. REV. 579, 599 (2018) ("A system has been defined as any set of distinct but interconnected elements or parts that operate as a unified whole to serve a function or purpose."); DRAPER L. KAUFMMAN, JR., SYSTEMS ONE: AN INTRODUCTION TO SYSTEMS THINKING 1 (1981) ("A system is a collection of parts which interact with each other to function as a whole."); Lynn M. LoPucki, *The Systems Approach to Law*, 80 CORNELL L. REV. 479, 482–83 (1997) ("To 'analyze' a system is to break it down into its constituent parts, to determine the nature and identify of its subsystems, and to explain the relationships among them.").

A. Law

In many accounts, law is the central focus for understanding corporate governance. We begin our exploration of the corporate governance machine with this component, setting out the main actors that create corporate law and regulate the business affairs of corporations: Delaware, Congress, and two federal agencies: the SEC and the Department of Labor ("DOL"). Together, these actors reflect all branches of government, interacting and constraining each other through principles of federalism, while maintaining a shareholder-oriented equilibrium for the past several decades.

1. Delaware

For more than a century, Delaware has held the top honor of being home to the greatest number of public corporations and producing the most influential corporate law.[83] In turn, the question of corporate purpose—the issue at the core of corporate governance, that shapes fiduciary decisionmaking and affects the legal landscape in myriad ways—is typically framed as whether Delaware legally requires fiduciaries to maximize shareholder wealth.

Since the Deal Decade of the 1980s, statements in Delaware case law and by prominent judges have suggested that 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."[84] But a vocal group of legal scholars have persistently pushed back on this interpretation in favor of a broader view of corporate purpose and fiduciary discretion. Some, for example, have argued that the deferential standard of judicial review known as the business judgment rule means that, practically speaking, directors are not legally constrained in their decision making to maximize shareholder value in most circumstances.[85] In recent years, however, the Delaware Court of Chancery has dealt several blows to these interpretations. For example, in *eBay v. Newmark*, the court rejected the argument that the founders of Craigslist could prioritize their community over their shareholders, stating the court "cannot accept as valid . . . a corporate policy that specifically, clearly, and admittedly seeks not to maximize the economic value of a for-profit corporation for the benefit of its stockholders."[86] And, although the Delaware Supreme Court has not revisited

---

[83] Mark J. Roe, *Delaware's Politics*, 118 HARV. L. REV. 2491 (2005).

[84] Leo E. Strine, Jr., *The Dangers of Denial: The Need for a Clear-Eyed Understanding of the Power and Accountability Structure Established by the Delaware General Corporation Law*, 50 WAKE FOREST L. REV. 761 (2015); *see also Revlon*, 506 A.2d at 182; eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 33 (Del. Ch. 2010) ("Promoting, protecting, or pursuing nonstockholder considerations must lead at some point to value for stockholders."); *in re* Trados Inc. S'holder Litig., 73 A.3d 17, 36 (Del. Ch. 2013) ("[T]he standard of conduct requires that directors seek to promote the value of the corporation for the benefit of its stockholders.").

[85] *See, e.g.*, LYNN STOUT, THE SHAREHOLDER VALUE MYTH: HOW PUTTING SHAREHOLDERS FIRST HARMS INVESTORS, CORPORATIONS, AND THE PUBLIC 30–31 (2012) [hereinafter STOUT, SHAREHOLDER VALUE MYTH]; Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 308–09 (1999); Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733, 763–69 (2005).

[86] *eBay*, 16 A.3d at 35.

this issue since its takeover jurisprudence of the 1980s,[87] a handful of other Chancery Court opinions contain similar statements.[88]

In addition to this language, albeit relatively scant, from Delaware courts emphasizing the interests of shareholders as the ultimate corporate ends, the statute also gives shareholders important control rights.[89] For example, shareholders are the only corporate constituency with the statutory power to elect board members and to bring derivative suits to hold them accountable.[90] Delaware has also recently amended its corporate code to provide the option of organizing as a "public benefit corporation," further suggesting that pursuing stakeholder interests is not the default rule for corporations.[91] For these reasons, many have observed that Delaware's default simply allows for an "enlightened" approach to shareholder primacy by leaving fiduciaries discretion to determine the value-maximizing course of action for shareholders over the long term.[92] On the whole, from a relatively small number of cases and statutory provisions, the idea that shareholder primacy is the law of the land in Delaware has become "widely accepted" in business, legal, and academic communities.[93]

Discussion of shareholder primacy often ends with Delaware law. However, it is only the beginning. The next sections discuss how federal law further reinforces a shareholder primacy view, and in many ways, a more exacting standard than that of Delaware.

2. Congress

From time to time, the federal government has taken on issues of corporate governance with national importance.[94] What shape do these incursions take? In the twenty-first century, since shareholder primacy has permeated the cultural and political discourse, federal intervention tends to protect shareholders, increasing their power and focusing management attention on their

[87] Cynthia Williams, *The Future of Shareholder Wealth Maximization: A Response to George Mocsary*, LAW & LIBERTY (Dec. 23, 2013), https://www.lawliberty.org/liberty-forum/the-future-of-shareholder-wealth-maximization-a-response-to-george-mocsary/; *see also* Robert J. Rhee, *A Legal Theory of Shareholder Primacy*, 102 MINN. L. REV. 1951, 1957 (2017) (noting the case law on a duty to maximize shareholder value is "scant").

[88] *See, e.g.*, Air Prods. & Chems., Inc. v. Airgas, Inc., 16 A.3d 48, 129 (Del. Ch. 2011) ("Directors of a corporation still owe fiduciaries to *all stockholders* . . . ."); *Trados*, 73 A.3d at 37 ("[T]he duty of loyalty therefore mandates that directors maximize the value of the corporation over the long-term for the benefit of the providers of equity capital . . . .").

[89] Leo E. Strine, Jr., *Corporate Power Is Corporate Purpose I: Evidence from My Hometown*, 32 OXFORD REV. ECON. POL'Y 176, 179 (2017) (asserting that "shareholders are the only corporate constituency with power under our prevailing system of corporate governance"); *cf.* Thompson, *supra* note 4, at 403–10 (discussing how corporate law creates shared power between managers, directors, and shareholders).

[90] Strine, *supra* note 89, at 184 (referencing DEL. CODE ANN. tit. viii, § 251, § 271 (2016) and DEL. CODE ANN. tit. viii, § 327 (2016)). Creditors join shareholders in the power to bring derivative suits to enforce fiduciary duties only when the corporation is insolvent. Quadrant Structured Prods. Co. v. Vertin, 115 A.3d 535, 546 (Del. Ch. 2015).

[91] *See* DEL. C. ANN. tit. viii, § 362.

[92] *See, e.g.*, Harper Ho, *"Enlightened Shareholder Value," supra* note 9, at 74–75.

[93] Rhee, *supra* note 87, at 1951, 1953–54 ("The data show that courts have pervasively embraced the concept that corporate managers should maximize shareholder wealth."); *see also* Joan Macleod Heminway, *Shareholder Wealth Maximization as a Function of Statutes, Decisional Law, and Organic Documents*, 74 WASH. & LEE L. REV. 939, 944 (2017) (describing "shareholder wealth maximization under various state laws (in and outside Delaware) as a function of firm-level corporate governance").

[94] *See* Mark J. Roe, *Delaware's Competition*, 117 HARV. L. REV. 588, 588 (2003) ("Delaware's chief competitive pressure comes not from other states but from the federal government."); Stephen M. Bainbridge, *The Creeping Federalization of Corporate Law*, 26 REG., Spring 2013, at 26 ("[T]here has been a creeping—but steady—federalization of corporate governance law.").

interests.[95] Consider, for example, corporate governance reforms enacted under the Dodd-Frank Act in the wake of the financial crisis: requiring a "say-on-pay" shareholder vote on executive compensation at public companies, providing for executive compensation clawbacks under certain circumstances, and allowing proxy access for shareholders to challenge incumbent management.[96] Likewise, the Sarbanes-Oxley Act of 2002 imposed many shareholder-friendly corporate governance requirements, including requiring corporate boards to have a majority of independent directors, and only independent directors on certain committees, including the audit and compensation committees.[97] That Act also required top executives to certify financial statements, with steep penalties for false certifications.[98] Each of these reforms incrementally tilted the balance of power in favor of shareholders.[99]

There are a handful of recent counter-examples, which demonstrate that the trend toward shareholder protection is not absolute and yet ultimately reinforce our general point. Perhaps the most well-known is the Dodd-Frank provision directing the SEC to issue a rule requiring companies to disclose their use of "conflict minerals."[100] Quite obviously, the rule was not adopted to further shareholder interests; it was enacted out of humanitarian concern about social harms arising from warfare in central Africa.[101] And it was immediately challenged in federal court by industry associations—the National Association of Manufacturers, the Chamber of Commerce, and the Business Roundtable.[102] After years of litigation, the D.C. Circuit concluded that the rule's disclosure requirements violated the First Amendment.[103] Then, in 2017, acting SEC Commissioner Michael Piwowar called the rule "misdirected" and implied that the SEC would not enforce the rule's due diligence requirements, the last substantive requirement not overturned by the D.C. Circuit decision.[104] That same year, signs emerged that even members of Congress viewed the

---

[95] *See* Christopher Bruner, *Center-Left Politics and Corporate Governance: What Is the 'Progressive' Agenda?*, 2018 BYU L. REV. 267, 286 (2018) (observing that "[s]ince the turn of the millennium, shareholder-centric corporate governance reforms at the federal level have picked up pace"); Lucian A. Bebchuk & Assaf Hamdani, *Federal Corporate Law: Lessons from History*, 106 COLUM. L. REV. 1793 (2006) (finding that federal intervention in corporate law has imposed tighter constraints on insiders to increase investor protection); *cf.* Ann M. Lipton, *Beyond Internal and External: A Taxonomy of Mechanisms for Regulating Corporate Conduct*, 2020 WIS. L. REV. 101, 104 (observing that when Congress legislates for stakeholders this is typically viewed as "external" to corporate governance).

[96] *See* Stephen M. Bainbridge, *Dodd-Frank: Quack Federal Corporate Governance Round II*, 95 MINN. L. REV. 1779, 1783 (2011).

[97] Robert Clark, *Corporate Governance Changes in the Wake of the Sarbanes Oxley Act: A Mortality Tale for Policymakers Too* (Harv. L. & Econ., Discussion Paper No. 525, 2005), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=808244.

[98] *Id.*

[99] That was so despite the fact that shareholder primacy was viewed by many as contributing to the crises that brought about the regulation. *See, e.g.*, William Bratton, *Enron and the Dark Side of Shareholder Value*, 76 TULANE L. REV. 1275, 1283 (2002); *see also* Larry Ribstein, *Bubble Laws*, 40 HOUS. L. REV. 77, 82 (2003) ("Public attention may be focused more on punishing the guilty than on preventing future harms.").

[100] Press Release, SEC, SEC Adopts Rule for Disclosing Use of Conflict Minerals (Aug. 22, 2012), https://www.sec.gov/news/press-release/2012-2012-163htm.

[101] *Fact Sheet: Disclosing Use of Conflict Minerals*, SEC, https://www.sec.gov/opa/Article/2012-2012-163htm---related-materials.html (last modified Mar. 14, 2017) (citing concern "that the exploitation and trade of conflict minerals by armed groups help[s] to finance conflict in the DRC region").

[102] Carter Wood, *Conflict Minerals Rule: Extraordinary Costs, Doubtful Benefits*, BUS. ROUNDTABLE (Jan. 18, 2013), https://www.businessroundtable.org/archive/media/blog/conflict-minerals-rule-extraordinary-costs-doubtful-benefits.

[103] Nat'l Ass'n of Mfrs. v. SEC, 800 F.3d 518, 530 (D.C. Cir. 2015) ("By compelling an issuer to confess blood on its hands, the statute interferes with the exercise of the freedom of speech under the First Amendment.").

[104] Michael S. Piwowar, Acting Chairman, SEC, Statement of Acting Chairman Piwowar on the Court of Appeals Decision on the Conflict Minerals Rule (Apr. 17, 2017), https://www.sec.gov/news/public-statement/piwowar-

conflicts minerals rule as a mistake—the House of Representatives twice passed bills that would eradicate the rule by repealing or eliminating funding for it.[105] This uncertainty has led many corporations to ignore the rule's requirements, as if never enacted into law.[106] And this pushback against Dodd-Frank's conflict minerals rule reinforces our observation that Congress usually intervenes in corporate governance to serve shareholder interests and, to the extent it is perceived as veering from that path, the corporate governance machine stands ready to push back.

3. Securities and Exchange Commission

Congress often delegates rulemaking and enforcement to agencies, and in this sub-Section, we focus on the most influential regulator of corporate behavior: the SEC, which was created after the stock market crash of 1929 and the Great Depression that ensued.[107] The agency articulates its mission as three-fold: "to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation."[108] The fact that the most influential regulator of financial markets and corporate behavior is charged with protecting *investors* suggests that advancing shareholder interests is a strong, if not dominant, focus for federal securities law.[109] Two aspects of the law illustrate this point: periodic corporate reporting requirements and SEC regulation of corporate affairs.

First, publicly traded companies are subject to periodic reporting requirements aimed at informing investors of information that is material to their trading.[110] Indeed, all corporate disclosure is subject to securities law, which frames its focus on generating information that is necessary or beneficial for investors, rather than stakeholders or the general public.[111] Federal securities laws embed this directive in the definition of "materiality," which courts have defined as whether there is a "substantial likelihood" that a "reasonable investor" would view the information as significant.[112] If information about a company's harmful environmental practices is not material to investors, for example, it need not be disclosed, no matter the value of the information to the

---

statement-court-decision-conflict-minerals-rule; SEC Div. of Corp. Fin., SEC, *Updated Statement on the Effect of the Court of Appeals Decision on the Conflict Minerals Rule* (Apr. 7, 2017), https://www.sec.gov/news/public-statement/corpfin-updated-statement-court-decision-conflict-minerals-rule.

105 Packaging Law Blog, Keller & Heckman LLP, *Conflict Minerals Rule Faces Uncertain Future*, NAT'L L. REV. (Oct. 6, 2017), https://www.natlawreview.com/article/conflict-minerals-rule-faces-uncertain-future (referencing H.R. 3354, 115th Cong. (2017) and H.R. 10, 115th Cong. (2017)).

106 Kelly Franklin, *US Investors Chide Companies for Thin Conflict Mineral Reports*, CHEMWATCH (June 14, 2018), https://chemicalwatch.com/67693/us-investors-chide-companies-for-thin-conflict-minerals-reports.

107 Pub. L. No. 73-291, 48 Stat. 881 (codified as amended at 15 U.S.C. §§ 78a-78mm (2000)).

108 SEC, *What We Do*, *supra* note 17.

109 Recent scholarship has argued that "securities laws force public companies to conform to the shareholder primacy view of corporate purpose" because the "fear of activist intervention" incentivizes companies "to maximize stock prices at the expense of all else." Jeff Schwartz, *De Facto Shareholder Primacy*, 79 MD. L. REV. 652, 655–56 (2020).

110 SEC, *What We Do*, *supra* note 17. The accounting standards that the SEC has adopted further enshrine a shareholder primacy view. *See* William Bratton, *Private Standards, Public Governance: A New Look at the Financial Accounting Standards Board*, 48 B.C. L. REV. 5, 28 (2007).

111 *See* Ann M. Lipton, *Not Everything Is About Investors: The Case for Mandatory Stakeholder Disclosure*, 37 YALE J. ON REG. 499, 502 (2020) ("[S]ecurities disclosures are not targeted toward the community at large; they are intended for investors alone, and when investors do not require disclosure, the general public is kept in the dark."); Donald C. Langevoort & Robert B. Thompson, *"Publicness" in Contemporary Securities Regulation After the JOBS Act*, 101 GEO. L.J. 337, 375–79 (2013) (noting "the conventional story for mandatory disclosure" focuses on "individual firms [and] investors" though disclosure is also justified on the basis of benefits to all citizens).

112 Basic Inc. v. Levinson, 485 U.S. 224, 232 (1988).

public.[113] In addition to regulating disclosure, the agency wields enforcement power against those who make fraudulent statements and omissions in connection with the purchase and sale of securities.[114] Quite obviously, these rules are intended to protect investors from fraud, and the ex ante effect is that issuers are hyper-focused on revealing information material *to investors* in a truthful manner.

Second, certain internal corporate affairs are subject to extensive regulation from the SEC, and the agency has repeatedly used its authority to protect shareholders as a group. Consider shareholder proposals. For years, the SEC has served as a gatekeeper by determining whether particular shareholder proposals must be included in public companies' annual proxy statements.[115] One could imagine a regime in which shareholders were allowed to bring proposals on any subject relevant to the corporation, including its workers and the environment. However, SEC rules limit the reach of proposals to those that benefit shareholders as a group, and any shareholder proposal that seeks to benefit only a subset of shareholders can be excluded.[116] Such a position implicitly enshrines wealth maximization—it is the lowest common denominator for a group of disparate shareholders. And the SEC regulates not just the content of shareholder proposals, but also how investors vote on them. For example, the SEC has adopted rules that regulate voting by institutional intermediaries by making clear that these "investment advisers" have a fiduciary duty to exercise votes to further their investors' interests.[117] This requirement has been interpreted by scholars and institutional investors alike as requiring a profit motive for voting decisions and limiting action by investment advisors to benefit stakeholders or the general public.[118]

An even more dramatic example of SEC action taken to benefit shareholders, and specifically expand shareholder voice, is proxy access. In 2010, the SEC passed—in "a close vote along partisan lines"—a rule that would grant shareholders the ability to add director nominees to the company's proxy.[119] But the rule was swiftly challenged by the Business Roundtable and the Chamber of Commerce, who argued that the rule would "distract[] directors and management from the performance of their responsibilities" and result in a "loss in shareholder value."[120] Ultimately, the D.C. Circuit overturned the rule,[121] leaving the choice to shareholders who could submit proposals to urge companies to adopt proxy access bylaws.[122]

---

113 ADVISORY COMM. ON CORP. DISCLOSURE, 95TH CONG., REP. TO THE SEC 391–99 (Comm. Print 1977) (concluding the SEC "should not try to use its powers to compel disclosure concerning, for instance, social or environmental matters, hiring practices, and the like, unless it could be shown that such matters were material to investors"); *see also* Jill E. Fisch, *Making Sustainability Disclosure Sustainable*, 107 GEO. L.J. 923, 935 (2019); Virginia Harper Ho, *Disclosure Overload? Lessons for Risk Disclosure & ESG Reporting Reform from the Regulation S-K Concept Release*, 65 VILL. L. REV. 67, 74 (2020).

114 SEC, *What We Do*, *supra* note 17.

115 Shareholder Proposals, 17 CFR § 240.14a-8; *see also* Donna Nagy, *Judicial Reliance on Regulatory Interpretations in SEC No-Action Letters: Current Problems and a Proposed Framework*, 83 CORNELL L. REV. 921 (1998).

116 Lipton, *supra* note 111, at 554.

117 Rules and Regulations, Investment Advisors, 17 C.F.R. § 275 (2003).

118 *See* Hart & Zingales, *supra* note 13; Max M. Schanzenbach & Robert H. Sitkoff, *Reconciling Fiduciary Duty and Social Conscience: The Law and Economics of ESG Investing by a Trustee*, 72 STAN. L. REV. 381 (2020).

119 Marcel Kahan & Edward Rock, *The Insignificance of Proxy Access*, 97 VA. L. REV. 1348 (2011).

120 Pet. for Review at 2, Bus. Roundtable v. SEC, No. 10-1305 (D.C. Cir. Sept. 29, 2010), https://www.law.du.edu/documents/corporate-governance/sec-and-governance/business-roundtable/Opening-Brief-of-Petitioners-Business-Roundtable-v-SEC-No-10-1305-DC-Cir-Nov-30-2010.PDF.

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

122 *See* AFSCME v. AIG, 462 F.3d 121 (2d Cir. 2006) (holding that Rule 14-8 did not exclude proxy access bylaw shareholder proposals). After that decision was issued, the SEC amended Rule 14-8 to overrule it, but in 2010, the

As the proxy access episode reveals, the SEC's path toward fulfilling its mission is not without controversy, and the agency has become increasingly politicized.[123] But as will be discussed in Section II.C.3, shareholder primacy has become enmeshed across both sides of the political aisle, indicating that increased polarization is unlikely to meaningfully change the agency's shareholderist orientation. Indeed, even pro-management action that is typically supported by Republican appointees tends to be described as benefitting shareholders. For example, the SEC recently proposed rules that would substantially raise the ownership thresholds and outcome hurdles for shareholder proposal submissions and resubmissions.[124] Critics complained that the new rules unjustly impede small retail shareholders from submitting proposals.[125] The SEC nonetheless couched the legal reform as advancing shareholder interests—reflecting that even when the agency gives management a victory, it often does so in the language of a shareholderist regulatory agenda.[126]

4. Department of Labor

Just as the SEC regulates investor conduct, so does the DOL, which is the federal agency with regulatory oversight over retirement accounts in the United States.[127] Specifically, the DOL sets standards of conduct for public and private pension funds subject to ERISA that manage trillions of dollars on behalf of U.S. employees and invest much of it in the stock market.[128] Importantly, ERISA imposes a fiduciary duty on investment advisors that invest pension fund assets, and the agency has interpreted this requirement as imposing a duty to maximize the plan's financial value.[129]

As clear proof of this orientation, the agency recently finalized a rule that prohibits plan fiduciaries from selecting plan assets based on non-financial objectives.[130] This rule specifically targeted ESG investment vehicles: the news release announcing the proposed rule stated that, "The proposal is designed, in part, to make clear that ERISA plan fiduciaries may not invest in ESG vehicles when they understand an underlying investment strategy of the vehicle is to subordinate

---

agency reversed course, adopting a new Rule 14a-8 that would permit shareholders to bring proxy access bylaw proposals under certain circumstances. *See* Reacting to Shareholder Proxy Access Proposals, Reed Smith Client Alert (Oct. 10, 2011), https://www.reedsmith.com/en/perspectives/2011/10/reacting-to-shareholder-proxy-access-proposals.

[123] *See, e.g.*, Joseph Engelberg et al., The Partisanship of Financial Regulators (Oct. 2019) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3481564.

[124] Press Release, SEC, SEC Proposes Rule Amendments to Improve Accuracy and Transparency of Proxy Voting Advice (Nov. 5, 2019) (available at: https://www.sec.gov/news/press-release/2019-231).

[125] *See* Kobi Kastiel & Yaron Nili, *The Giant Shadow of Corporate Gadflies*, 94 S. CAL. L. REV. (forthcoming 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3520214; Robert Jackson Jr., Commissioner, SEC, Statement on Proposals to Restrict Shareholder Voting, https://www.sec.gov/news/public-statement/statement-jackson-2019-11-05-open-meeting (Nov. 5, 2019).

[126] *See, e.g.*, SEC Proposed Rules, 17 CFR Part 240 at 140, https://www.sec.gov/rules/proposed/2019/34-87458.pdf (justifying elevated resubmission hurdles as benefitting shareholders by allowing them "to focus on the processing of proposals that may garner higher levels of voting support," among other things).

[127] *About Us*, U.S. DEP'T OF LAB., https://www.dol.gov/general/aboutdol.

[128] *Total Assets of Pension Funds in the United States*, STATISTA, https://www.statista.com/statistics/421729/pension-funds-assets-usa/; Heather Gillers, *Public Pension Plans Continue to Shift Into U.S. Stocks*, WALL ST. J. (Nov. 5, 2019), https://www.wsj.com/articles/public-pension-plans-continue-to-shift-into-u-s-stocks-11572955200 .

[129] 29 C.F.R. § 2550.404a-1 (2020); *see also* Schanzenbach & Sitkoff, *supra* note 118, at 407.

[130] 29 C.F.R. § 2509 & 2550 (2020).

return or increase risk for the purpose of non-financial objectives."[131] In other words, the agency has adopted a particularly stringent form of shareholder primacy, requiring plan fiduciaries to have an "unwavering focus" on shareholder wealth maximization and removing any discretion to consider non-economic shareholder value more broadly.[132] And this example is particularly revealing because it again shows how government policy not only facilitates the aggregation of governance power in the hands of influential investors, but also influences how that money is invested, and how governance rights are exercised. By pressuring institutional intermediaries to maximize shareholder wealth and explicitly rejecting consideration of any non-pecuniary shareholder value, the Department of Labor is likely to redirect the investment of billions of dollars of retirement dollars away from ESG funds, which will have an impact on governance for years to come.[133]

B. Markets

Corporate governance is not only a creature of law, but also of markets. By markets, we refer to the institutional players who participate in the market for corporate governance—*i.e.*, that are responsible for shaping the body of extra-legal rules and norms that powerfully shape corporate behavior. Indeed, as we show, these market players contribute to the corporate governance environment that companies operate in—as much, or even more so, than the operation of law. In this Section, we describe the many players in the corporate governance industry, and their role in focusing company attention on shareholder interests.

1. Influential Investors

Today's investors are more powerful than ever before. As a result of capital market concentration, the largest shareholders in most public companies are investment intermediaries with the heft and sophistication to wield their governance power to advance shareholder interests.[134] Although these intermediaries vary in their level of engagement and investment strategy, all put further pressure on management to focus on shareholder value.

Historically, only hedge fund activists and pension funds engaged in shareholder activism.[135] Hedge fund activists generally use their governance rights to induce the targeted company to maximize shareholder wealth, and marshal support from other shareholders to this cause.[136] Of

---

[131] News Release, U.S. Dep't of Lab., U.S. Department of Labor Proposes New Investment Duties Rule (June 23, 2020), https://www.dol.gov/newsroom/releases/ebsa/ebsa20200623-0.
[132] *Id.*; *see also* Lipton, *supra* note 9, at 889–90 (discussing how the Bush and Trump administrations promulgated guidance advising that ERISA trustees should avoid consideration of ESG factors whereas the Obama administration granted more discretion).
[133] *See* Lipton, *supra* note 9, at 688 ("[T]he existence of different types of investors, their preferences with respect to corporate behavior, their risk tolerance, and their time horizons, are all at least partially a product of regulatory choice."); *see also* Mark Schoeff, *DOL Releases Final Rule that Could Curb ESG in Retirement Plans*, INV. NEWS (Oct. 30, 2020), https://www.investmentnews.com/dol-final-rule-curb-esg-retirement-plans-198846.
[134] *See, e.g.*, John C. Coates, *The Future of Corporate Governance Part I: The Problem of Twelve* 2 (Harv. Pub. L., Working Paper No. 19-07, 2018), https://ssrn.com/abstract=3247337 (discussing how "control of most public companies – that is the wealthiest organizations in the world, with more revenue than most states – will soon be concentrated in the hands of a dozen or fewer [institutions]").
[135] *See* Bernard S. Black, *Shareholder Passivity Reexamined*, 89 MICH. L. REV. 520, 567 (1990); Rock, *supra* note 79.
[136] Marcel Kahan & Edward B. Rock, *Hedge Funds in Corporate Governance and Corporate Control*, 155 U. PA. L. REV. 1021, 1029, 1064 (2007).

course, this role is not without controversy, as some critics view their activism as harming long-term shareholder value—but note, again, that even this dominant form of criticism takes shareholder value as the lodestar.[137] Pension funds, and public pension funds in particular, are also active shareholders,[138] although their incentives and objectives are less clear cut—on the one hand, federal guidance suggests their fiduciary duty requires pursuing economic value for plan participants,[139] on the other, those participants are generally employees whose interests may conflict with shareholders more broadly.[140]

Over the past decade, hedge funds and pension funds have remained active, but the most notable trend has been the rising influence of mutual funds. Today, the mutual fund giants—Vanguard, BlackRock, and State Street, or the so called "Big Three" —together hold over 20% of the equity of S&P 500 companies.[141] And these powerful shareholders have begun to articulate a broader view of fiduciary responsibility and corporate purpose. For example, in a 2018 public letter to company CEOs, BlackRock CEO Larry Fink explained,"[t]o prosper over time, every company must not only deliver financial performance, but also show how it makes a positive contribution to society. Companies must benefit all of their stakeholders, including shareholders, employees, customers, and the communities in which they operate."[142] This statement was celebrated as an embrace by one of the world's largest investors of a stakeholder model, and an abandonment of shareholder primacy.[143]

But a closer look reveals that Fink's letter is squarely aligned with the pursuit of shareholder value, and economic return in particular. In a second letter, Fink explained that "profits and purpose are inextricably linked. Profits are essential if a company is to effectively serve all of its stakeholders over time . . . . Similarly, when a company truly understands and expresses its purpose, it functions with the focus and strategic discipline that drive long-term profitability."[144]

The Big Three's voting guidelines further illustrate the link between their governance initiatives and shareholder value. For example, Vanguard explains: "we believe that good governance practices—thoughtful board composition, effective oversight of company strategy and risks,

---

[137] *See, e.g.*, John Coffee & Darius Palia, *The Wolf at the Door: The Impact of Hedge Fund Activism on Corporate Governance*, 1 ANNALS OF CORP. GOV. 1, 7–8 (2016).

[138] *See, e.g.*, Stewart J. Schwab & Randall S. Thomas, *Realigning Corporate Governance: Shareholder Activism by Labor Unions*, 96 MICH. L. REV. 1018, 1019 (1998) ("[L]abor activism is a model for any institutional investor attempting to maximize return on capital.").

[139] *See, e.g.*, *supra* note 131 (discussing DOL investment duties rule); DAVID WEBBER, THE RISE OF THE WORKING-CLASS SHAREHOLDER: LABOR'S LAST BEST WEAPON (2018) xii, 43–44 (discussing "the massive growth of worker pension funds" and their shareholder activism "to make corporate managers more accountable to long-term shareholders").

[140] *See* Roberta Romano, *Public Pension Fund Activism in Corporate Governance Reconsidered*, 93 COLUM. L. REV. 795, 796 (1993) (arguing that public pension fund managers face "considerable political pressure to temper investment policies with local considerations, such as fostering in-state employment, which are not aimed at maximizing the value of their portfolios' assets").

[141] Lucian Bebchuk & Scott Hirst, *The Specter of the Giant Three*, 99 B.U. L. REV. 721, 735, fig.1 (2019) ("The average combined stake in S&P 500 companies held by the Big Three essentially quadrupled over the past two decades, from 5.2% in 1998 to 20.5% in 2017.").

[142] Annual Letter from Larry Fink, CEO, BlackRock, to CEOs, A Fundamental Reshaping of Finance (Jan. 2020) (available at: https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter).

[143] *See, e.g.*, David J. Berger, *Reconsidering Stockholder Primacy in an Era of Corporate Purpose*, 74 BUS. LAW. 659, 662–63 (2019).

[144] Fink, *supra* note 142.

aligned pay for performance, and strong provisions to empower shareholders—are the foundation on which a company's board of directors can build enduring shareholder value."[145] Likewise, BlackRock explains: "Our engagement priorities promote sound corporate governance and business practices that are consistent with sustainable long-term financial return."[146] And finally, State Street explains that it prioritizes ESG issues that will have "the most material impacts on the long-term value of our portfolio companies."[147] In sum, while some of these institutional investors have recently highlighted the importance of stakeholder interests, there is no sign that they have abandoned the pursuit of long-term shareholder value.[148] Rather than indicating a sharp turn toward stakeholder capitalism, Fink's statements may instead reflect an enlightened approach to shareholderism that views consideration of stakeholder welfare as a necessary precondition to maximizing shareholder value.[149]

We should not be surprised that institutional investors ultimately reinforce a shareholder primacy viewpoint, even while championing an enlightened perspective. For one, like pension funds, mutual funds have a fiduciary duty to act in the best interests of their clients, and as discussed, this duty has been interpreted as requiring wealth maximization.[150] Not only that, institutional shareholders will pursue financial performance so long as that is the metric by which their customers evaluate them.

2. Investor Associations

Influential investors exert pressure not only on their own, but also in coordination with other investors via associations. The most influential of these associations is the Council of Institutional Investors.[151] Founded in 1985, "CII" espouses the goal of advancing "strong governance standards at public companies and strong shareholder rights."[152] Today, its membership includes more than 140 asset managers, including public pension funds, corporate and labor funds, foundations and

---

145 VANGUARD, INVESTMENT AND STEWARDSHIP (2019).

146 *Investment Stewardship*, BLACKROCK, https://www.blackrock.com/corporate/about-us/investment-stewardship#our-responsibility (last visited Jan. 25, 2021).

147 *Asset Stewardship*, STATE ST. GLOB. ADV'RS, https://www.ssga.com/us/en/individual/mf/capabilities/esg/asset-stewardship (last visited Jan. 25, 2021).

148 An incentive to maximize long-term *portfolio* value could also help explain emphasis on sustainability and stakeholders. *See* John Armour & Jeffrey N. Gordon, *Systemic Harms and Shareholder Value*, 6 J. L. ANALYSIS 35, 39 (2014) ("[S]hare price maximization can in the presence of systemic externalities lead to reduced portfolio returns to investors."); Condon, *supra* note 11, at 5 (2020) (explaining institutional investor support of climate activism by framing value maximization at portfolio rather than firm level).

149 More cynically, they may represent a savvy marketing campaign designed to convince investors that by choosing a BlackRock fund, they can have it all—wealth maximization and a social impact. *See, e.g.*, Michal Barzuza, Quinn Curtis & David H. Webber, *Shareholder Value(s): Index Fund Activism and the New Millennial Corporate Governance*, 93 S. CAL. L. REV. (forthcoming 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3439516 (arguing that index funds are competing for investments from Millennials who place a premium on social values).

150 *See* Investment Advisers Act Release No. 2256 (July 2, 2004); Hart & Zingales, *supra* note 13.

151 Although CII is the most prominent investor advocacy group, others exert influence. For example, the Investor Stewardship Group represents sixteen investor members with $17 trillion in assets under management. *About ISG*, INV'R STEWARDSHIP GRP., https://isgframework.org/ (last visited Jan. 25, 2021). That group has outlined a "stewardship code" for U.S. companies with six main principles, including "boards are accountable to shareholders" and "boards should be responsive to shareholders." Abe M. Friedman, *Investor Coalition Publishes U.S. Stewardship Code*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Feb. 9, 2017), https://corpgov.law.harvard.edu/2017/02/09/investor-coalition-publishes-u-s-stewardship-code/.

152 *About CII*, COUNCIL OF INST. INV'RS (CII), https://www.cii.org/about (last visited Jan. 25, 2021).

endowments, with a combined assets under management of $39 trillion.[153] The association's website boasts that "institutional shareowners have a much greater voice today than they did in 1985 in part because of the constant vigilance and hard work of CII to protect and strengthen that voice."[154]

How does CII strengthen shareholder voice? In coordination with its members, the organization has developed an extensive body of policies that embrace accountability to shareholders[155] and shareholder participation in governance.[156] The organization pursues all avenues to gain adherence to these goals—it "advocates vigorously for CII policies via speeches, reports, letters and testimony."[157] For example, in response to the Business Roundtable's revised statement in favor of running companies "for the benefit of all stakeholders," the CII responded publicly with a sharp rebuttal that companies must "sustain a focus on long-term shareholder value" and operate with "clear accountability to company owners."[158] In addition to this kind of public advocacy, CII staff and members also engage directly with "corporate managers and directors, stock exchange officials, regulators and policymakers."[159]

As the CII example reveals, investor advocacy groups help enshrine a shareholder primacy viewpoint. To secure broad participation, the groups adopt principles that they frame as shared in common by institutional investors. And once investors have signed on, the groups have powerful leverage to influence company behavior to further shareholder interests.

3. Industry Associations

Institutional investors are not the only entities that work in association to advance their interests; corporate executives do too.[160] And some of these industry associations are active participants in the corporate governance machine, engaging in advocacy on issues related to governance, and often pushing pro-management positions with the claimed objective of serving shareholder interests.

The Business Roundtable, an association of CEOs of large U.S. public companies, is one prominent example, and its revised statement of corporate purpose in particular. In 2019, the Business Roundtable revised its standing statement that "corporations exist principally to serve

---

[153] *Id.*
[154] *Id.*
[155] *Policies on Corporate Governance*, CII, https://www.cii.org/corp_gov_policies ("Corporate governance structures and practices should protect and enhance a company's accountability to its shareowners . . . .").
[156] *Id.* ("Shareowners should have meaningful ability to participate in and vote on the major fundamental decisions that affect corporate viability, and meaningful opportunities to suggest or nominate director candidates and to suggest processes and criteria for director selection and evaluation."); *see also* Tim C. Opler & Jonathan Sobokin, *Does Coordinated Institutional Activism Work?: An Analysis of the Activities of the Council of Institutional Investors* (Dice Ctr. for Rsch. in Fin. Econ., Working Papers Series 95-5, 1996), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=46880 (discussing how CII provided a forum for public and private pension funds to coordinate shareholder activism).
[157] *Issues & Advocacy*, CII, https://www.cii.org/issues_advocacy (last visited Jan. 25, 2021).
[158] Press Release, CII, Council of Institutional Investors Responds to Business Roundtable Statement on Corporate Purpose (Aug. 19, 2019) [hereinafter CII Response], https://www.cii.org/aug19_brt_response.
[159] *Id.*
[160] LEE DRUTMAN, THE BUSINESS OF AMERICA IS LOBBYING: HOW CORPORATIONS BECAME POLITICIZED AND POLITICS BECAME MORE CORPORATE 98 (2015).

their shareholders."[161] Specifically, the organization issued a press release announcing the signatories' commitment to running companies "for the benefit of all stakeholders—customers, employees, suppliers, communities and shareholders."[162] But rather than representing a full embrace of stakeholderism, the statement framed its new commitment to stakeholders as a means of "[g]enerat[ing] long-term value for shareholders."[163] And even this incremental reframing generated a hostile response from many, including investor associations (including the CII) and academics who responded with a defense of shareholder primacy.[164]

Other industry associations have taken positions with even stronger claims about serving shareholder interests. For example, the National Association of Manufacturers launched "The Main Street Investors' Coalition," and lobbied the SEC to make it harder for shareholders to submit proposals. The organization claimed its motivation was to advance the interests of "main street investors" whose voices had been drowned out by large institutional shareholders.[165]

Why would industry associations prioritize shareholder interests? The answer, we believe, is that they generally don't; instead, it appears that corporate managers pursue their own interests by touting shareholder welfare as a way to attract broad support for reforms that increase management power and insulation. As the Main Street Investors' Coalition example reveals, when management is faced with unwanted pressure from vocal groups of shareholders, business associations may seek reform that minimizes their voice, in the guise of protecting shareholders at large. More broadly, these examples reflect a pattern of industry associations working within the corporate governance machine to achieve their aims, even when those aims run directly counter to the machine's pro-shareholder orientation.

4. Proxy Advisors

Proxy advisors are an important recent addition to the corporate governance machine.[166] These private companies collect information, analyze corporate elections, and provide voting recommendations to clients for a fee.[167] And as the stock market has consolidated in the hands of institutional investors, the proxy advisors that advise them have gained in power and influence.[168]

---

[161] David Gelles & David Yaffe-Bellany, *Feeling Heat, C.E.O.s Pledge New Priorities*, N.Y. TIMES, Aug. 20, 2019, at A1.
[162] Business Roundtable, Press Release, Business Roundtable Redefines the Purpose of a Corporation to Promote 'An Economy That Serves All Americans' (Aug. 19, 2019), https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans.
[163] Business Roundtable, Statement on the Purpose of a Corporation (Aug. 19, 2019), https://opportunity.businessroundtable.org/wp-content/uploads/2020/06/BRT-Statement-on-the-Purpose-of-a-Corporation-with-Signatures.pdf.
[164] *See, e.g.*, CII Response, *supra* note 158; Jesse Fried, *Shareholders Always Come First and That's a Good Thing*, FIN. TIMES (Oct. 7, 2019), https://www.ft.com/content/fff170a0-e5e0-11e9-b8e0-026e07cbe5b4; Bebchuk & Tallarita, *supra* note 5.
[165] *Id.*
[166] *See* Stephen Choi, Jill E. Fisch & Marcel Kahan, *The Power of Proxy Advisors: Myth or Reality?*, 59 EMORY L.J. 869, 870 (2010).
[167] *Id.* at 871.
[168] This reality is compounded by the fact that the DOL and SEC urge institutional investors to vote all of the proxies of their portfolio company investments. *See* Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies, 68 Fed. Reg. 6564, 6565 (Feb. 7, 2003) (codified at 17 C.F.R. pts. 239. 249, 270, 274); Letter from Alan D. Lebowitz, Deputy Assistant Sec'y, Dep't of Labor, to Helmuth Fandl, Chairman of Ret. Bd., Avon Prods., Inc., Dep't of Labor Interpretive Letter on Avon Products, Inc. Employees' Retirement Plan, 1988 WL 897696, at *2 (Feb. 23, 1988).

Institutional investors hold approximately 80% of public company shares, but their structure and financial model limits their ability to research and cast informed votes on all matters without incurring significant costs, thus opening the door for proxy advisors to help guide their voting decisions.[169] Consider the mutual fund company Vanguard, which cast 170,000 votes for 13,000 portfolio companies last year.[170] To accomplish this task, the institution often outsources research and voting decisions to two proxy advisors: Institutional Shareholder Services (ISS) and Glass Lewis & Co. Other large institutional investors generally do the same.[171] As a result, the two dominant proxy advisor firms wield ample power in corporate elections, shifting a significant percentage of shareholder votes.[172]

Because proxy advisors supply voting advice on thousands of different companies each year, they are forced to be generalists on a wide range of governance issues that commonly arise, ranging from proxy access to corporate political spending disclosures.[173] To supply advice at scale, they reach conclusions about "best practices" on each issue and then set governance guidelines that are enforced through their voting guidance.[174] As a result, proxy advisors influence not only investor voting, but also board and management behavior before the corporate proxy even arrives: Many companies proactively adopt governance policies that mesh with ISS and Glass Lewis recommendations, and sometimes even seek their behind-the-scenes consulting advice on executive compensation packages and management-sponsored proposals to increase the likelihood that shareholders will approve them.[175]

---

[169] *See* Jill E. Fisch, Assaf Hamdani & Steven Davidoff Solomon, *The New Titans of Wall Street: A Theoretical Framework for Passive Investors*, 168 U. PA. L. REV. 17, 46, 50–51 (2019); Dorothy S. Lund, *The Case Against Passive Shareholder Voting*, 43 J. CORP. L. 493, 516 (2018); BlackRock Investment Stewardship, at 13 ("[I]n most markets we subscribe to two research providers.").

[170] VANGUARD INV. STEWARDSHIP TEAM, VANGUARD, INVESTMENT STEWARDSHIP: 2019 ANNUAL REPORT 8 (Aug. 29, 2019), https://about.vanguard.com/investment-stewardship/perspectives-and-commentary/2019_investment_stewardship_annual_report.pdf.

[171] BlackRock Investment Stewardship 2019, at 13, https://www.blackrock.com/corporate/literature/publication/blk-profile-of-blackrock-investment-stewardship-team-work.pdf ("[I]n most markets we subscribe to two research providers."); Joseph A. McCahery, Zacharias Sautner & Laura T. Starks, *Behind the Scenes: The Corporate Governance Preferences of Institutional Investors*, 71 J. FIN. 2905, 2924 (2016) (finding that a majority of institutional investor respondents agreed that proxy advisors help them make informed voting decisions).

[172] *Id.* (finding that "proxy advisors do not just aggregate shareholder preferences or coincide with them, but actually influence voting decisions"); TIMOTHY M. DOYLE, AM. COUNCIL FOR CAP. FORM., THE REALITIES OF ROBO-VOTING 6 (Nov. 2018), http://accfcorpgov.org/wp-content/uploads/ACCF-RoboVoting-Report_11_8_FINAL.pdf (estimating ISS influence as being "between 6-11% and up to 25%"); Choi et al., *The Power of Proxy Advisors, supra* note 166 (estimating that an ISS recommendation shifts 6%-10% of the shareholder votes); David F. Larcker, Brian Tayan & James R. Copland, *The Big Thumb on the Scale: An Overview of the Proxy Advisory Industry*, HARV. L. SCH. F. ON CORP. GOVERNANCE (June 14, 2018), https://corpgov.law.harvard.edu/2018/06/14/the-big-thumb-on-the-scale-an-overview-of-the-proxy-advisory-industry/ (discussing studies finding that proxy advisors can influence up to 30% of shareholder voting).

[173] *See* Nadaya Malenko & Yao Shen, *The Role of Proxy Advisory Firms: Evidence from a Regression-Discontinuity Design*, 29 REV. F. STUD. 29 (2019).

[174] *Id.*; David F. Larcker, Allan L. McCall & Brian Tayan, *And Then A Miracle Happens!: How Do Proxy Advisory Firms Develop Their Voting Recommendations?* (Stan. Closer Look Series, 2013), https://www.gsb.stanford.edu/sites/gsb/files/publication-pdf/cgri-closer-look-31-proxy-firms-voting-recommendations.pdf.

[175] *See, e.g.*, David F. Larcker, Allan L. McCall & Gaizka Ormazabal*, Outsourcing Shareholder Voting to Proxy Advisory Firms*, 58 J. L. & ECON. 173 (2015). In addition, in 2020, the SEC approved new rules that require proxy firms to provide their research to companies at the same time as their investor clients and to share rebuttals to their advice from executives. SEC, Exemptions from the Proxy Rules for Proxy Voting Advice, Release No. 34-89372 (July 22, 2020), https://www.sec.gov/rules/final/2020/34-89372.pdf.

What do these influential advisors recommend? A perusal of ISS's voting principles reveals that shareholder primacy is deeply ingrained in its policies. For example, its principles state that ISS aims to promote "long-term shareholder value creation" and encourage practices that respect shareholder rights.[176] The guidelines further explain that "boards should be accountable to shareholders, the owners of the companies," "shareholders should have meaningful rights on structural provisions," and "boards should be sufficiently independent so as to ensure that they are able and motivated to effectively supervise management . . . for the benefit of all shareholders."[177] Likewise, Glass Lewis's policies explain that the purpose of its proxy research is to "facilitate shareholder voting in favor of governance structures that will . . . create shareholder value."[178]

It is unsurprising that proxy advisors would proclaim a commitment to shareholder value because this is what their institutional investor clients believe they are duty-bound to pursue.[179] And even when proxy advisors offer advice relevant to stakeholder interests, those guidelines do not abandon a shareholder primacy viewpoint. Instead, proxy advisor ESG guidelines generally seek to "align responsible investment policies and practices with shareholder interests."[180] This orientation is generally consistent with the voting guidelines of many large institutional investors and may help explain why many ESG-oriented funds often vote against environmental and social shareholder proposals, just like the shareholder value-oriented funds in the institution.[181] Ultimately, the principal goal of proxy advisor advice is to render management more accountable to shareholder interests, which makes it difficult to pursue stakeholder welfare whenever doing so conflicts with shareholder wealth maximization.

5. Stock Exchanges

The New York Stock Exchange (NYSE) is the world's largest stock exchange, and it creates many corporate governance rules that apply to its 2,800 listed companies.[182] These detailed rules influence the conduct of those companies, and they have a distinct shareholder primacy flavor. As the NYSE explained in its corporate governance guide, "companies need corporate governance

---

[176] *ISS Global Voting Principles*, ISS, https://www.issgovernance.com/policy-gateway/iss-global-voting-principles/.
[177] *Id.*
[178] GLASS LEWIS, 2020 GUIDELINES: AN OVERVIEW OF THE GLASS LEWIS APPROACH TO PROXY ADVICE FOR THE UNITED STATES 3 (Nov. 2020), https://www.glasslewis.com/wp-content/uploads/2016/11/Guidelines_US.pdf.
[179] *See* Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies, Securities Act Release No. 8188, Exchange Act Release No. 47,304, Investment Company Act Release No. 25,922, 68 Fed. Reg. 6564, 6565 (Feb. 7, 2003); Schanzenbach & Sitkoff, *supra* note 118 (discussing fiduciary duties of trustees of pension funds).
[180] ISS ESG, RESPONSIBLE INVESTMENT SOLUTIONS, https://perma.cc/TFB6-M94K.
[181] *See* Patrick Temple-West, *Big US Sustainable Funds Fail to Support ESG Shareholder Proposals*, FIN. TIMES (Sept. 7, 2019), https://www.ft.com/content/5d342a5d-443d-3327-9502-2361f37f251c (noting "funds labelled by BlackRock, JPMorgan Asset Management and Vanguard as sustainable frequently sided with a company's management and against shareholder proposals on [ESG-related] issues"); Caleb N. Griffin, *Environmental & Social Voting at Index Funds*, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3542081 (discussing the voting policies of BlackRock, Vanguard, and State Street on E&S shareholder proposals and their low levels of support); Jackie Cook & Jon Hale, *2019 ESG Proxy Voting Trends by 50 U.S. Fund Families*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Mar. 23, 2020), https://corpgov.law.harvard.edu/2020/03/23/2019-esg-proxy-voting-trends-by-50-u-s-fund-families/#4 (describing how asset managers operationalize voting strategies and providing summary voting data on ESG shareholder proposals).
[182] Kristin N. Johnson, *Regulating Innovation: High Frequency Trading in Dark Pools*, 42 J. CORP. L. 833, 839 (2017).

policies that place the interests of their shareholders first."[183] As such, the stock exchange requires corporate boards to have a majority of independent directors and key committees populated by only these independent directors.[184] In addition, the exchange mandates a say-on-pay shareholder vote.[185] Compliance with these standards is enforced by a division of the exchange known as NYSER; the organization can enforce violations with penalties or delisting.[186] The NYSE's closest competitor, the Nasdaq Stock Market, follows a similar approach.[187]

What motivates NYSE and Nasdaq to adopt these rules? The stock exchanges are public companies themselves and tend to follow the demands of other institutions driving the market for listings.[188] In addition, the exchanges must file their rules with the SEC for review,[189] and on occasion, Congress has mandated that the exchanges adopt certain listing standards.[190] This regulatory oversight likely contributes to the exchanges' focus on "good governance" that privileges shareholders; if the NYSE or Nasdaq drop listing standards below some perceived acceptable level, they may be subject to additional scrutiny. As a result, absent a significant shift in this regulatory agenda and dynamic, we can expect the stock exchanges will continue to regulate listed companies with an investor-focused mandate.[191]

6. Stock Indices

Unlike stock exchanges, which have influenced company governance for over a century, stock indices are a more recent addition to the system. A stock index is a measurement of a section of the stock market, often used as a benchmark for actively managed mutual funds or a baseline for passively managed mutual funds.[192] In the United States, thousands of indices exist, but three dominate the market: the S&P 500, the Dow Jones Industrial Average, and the NASDAQ

---

183 Tom Farley, *Foreward*, *in* NYSE: CORPORATE GOVERNANCE GUIDE vi (Steven A. Rosenblum et al. eds., White Page Ltd. 2014), https://www.nyse.com/publicdocs/nyse/listing/NYSE_Corporate_Governance_Guide.pdf.

184 Glenn H. Booraem, *An Institutional Investor's Viewpoint on Corporate Governance*, *in* NYSE: CORPORATE GOVERNANCE GUIDE 14 (Steven A. Rosenblum et al. eds., White Page Ltd. 2014), https://www.nyse.com/publicdocs/nyse/listing/NYSE_Corporate_Governance_Guide.pdf.14.

185 *Id.*

186 *See Disciplinary Actions*, NYSE, https://www.nyse.com/regulation/disciplinary-actions (last visited Jan. 25, 2021).

187 *Corporate Governance Rules FAQ*, LISTING CTR., NASDAQ, https://listingcenter.nasdaq.com/show_doc.aspx?file=faqscorpgov.html (last visited Mar. 2, 2020).

188 *See* Paul G. Mahoney, *The Exchange as Regulator*, 83 VA. L. REV. 1453, 1500 (1997) ("Exchanges have strong incentives to provide rules of market structure that investors want and to compel adherence by their members to contractual and fiduciary obligations."); *see also* Adam C. Pritchard, *Markets as Monitors: A Proposal to Replace Class Actions with Exchanges as Securities Fraud Enforcers*, 85 VA. L. REV. 925, 963–64 (1999) (explaining that "[e]xchanges serve corporations by providing liquidity for their securities" and have incentives to protect investors).

189 17 C.F.R. § 2401.19b-4 (2013); NYSE, Rules and Interpretations, https://www.nyse.com/regulation/nyse-american/rules-and-interpretations; Nasdaq Regulation, Rulebook, listingcenter.nasdaq.com/rulebook/Nasdaq/rules/Nasdaq-5000.

190 *See, e.g.*, *Corporate Governance Issues, Including Executive Compensation Disclosure and Related SRO Rules*, SEC Spotlight, https://www.sec.gov/spotlight/dodd-frank/corporategovernance.shtml.

191 *See* Joel Seligman, *Equal Protection in Shareholder Voting Rights: The One Common Share, One Vote Controversy*, 54 GEO. WASH. L. REV. 687, 694–97 (1986).

192 Adriana Z. Robertson, *The (Mis)Uses of the S&P 500* (Sept. 6, 2019) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3205235 [hereinafter Robertson, *(Mis)Uses*].

Composite.[193] These three major indices are sufficiently important drivers of investor demand for company shares that their standards for inclusion can influence corporate behavior.[194]

Consider the S&P 500, the world's most-tracked index by assets under management that contains "500 of the top companies in leading industries of the U.S. economy."[195] Contrary to popular understanding, the construction of the index is not passive or neutral; an index committee of the S&P Dow Jones exercises significant discretion over the methodology for determining eligibility and inclusion.[196] Like the stock exchanges, the index adopts governance standards aiming to "protect the integrity and quality of [S&P's] benchmarks as well as comply with applicable regulatory standards and accepted industry practices."[197]

The business model of index creators like S&P Dow Jones tells us something about their motivation in carrying out these stated goals: their profits depend on licensing the use of their indices to asset managers for portfolio construction or fund benchmarks.[198] This logic would seem to suggest that the S&P eligibility standards would seek to eliminate poorly governed companies, as doing so should boost the performance of the index over time and increase demand for it. However, a misalignment also exists: regardless of actual company performance, the index provider may have an incentive to cater to the wishes of its asset manager clients so as to maximize profits from licensing fees.[199] And this incentive further suggests that the governance standards adopted by indices will reflect the preferences of their clients.

Take the major indices pushback on dual-class equity companies as an example of these incentives in action. In the wake of an increase in dual-class technology company IPOs, several major index providers, including S&P Dow Jones, declared that they would exclude dual-class companies from their indices.[200] These index providers acted without unequivocal evidence that these structures harm firm performance.[201] Instead, the choice seems to have been a response to

---

[193] Bloomberg News, *There Are Now More Indexes than Stocks*, BLOOMBERG (May 12, 2012, 2:00 AM), https://www.bloomberg.com/news/articles/2017-05-12/there-are-now-more-indexes-than-stocks.

[194] Robertson, *(Mis)Uses*, *supra* note 192 (manuscript at 2) (noting it has been recognized since at least the mid-1980s that "stocks tend to jump after being added to the S&P 500"); Lysle Boller & Fiona M. Scott Morton, *Testing the Theory of Common Stock Ownership* (NBER Working Paper No. w27515), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3649879 (finding that stocks entering the S&P 500 index experience a significant increase in institutional ownership and stock returns); *but see* Benjamin Bennett, René M. Stulz & Zexi Wang, *Does Joining the S&P 500 Index Hurt Firms?* (Fisher College of Business Working Paper No. 2020-03-017), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3656628 (finding that the long-run impact of index inclusion is negative).

[195] S&P 500, S&P DOW JONES INDICES, https://us.spindices.com/indices/equity/sp-500; Robertson, *(Mis)Uses*, *supra* note 192.

[196] *See* Robertson, *(Mis)Uses*, *supra* note 192 (manuscript at 1, 4, 6–8).

[197] *Governance*, S&P DOW JONES INDICES, https://us.spindices.com/governance/overview/.

[198] Adriana Z. Robertson, *Passive in Name Only: Delegated Management and 'Index' Investing*, 36 YALE J. ON REG. 795, 846 (2019).

[199] *See* Robertson, *(Mis)Uses*, *supra* note 192 (manuscript at 6–7, 23) (describing the changing methodology and composition of the index and the competing client interests depending on use for index funds or benchmarks); Scott Hirst & Kobi Kastiel, *Corporate Governance by Index Exclusion*, 99 B.U. L. REV. 1229, 1246 (2019) (exploring the conflicts of interest that index providers face).

[200] *See* Dorothy S. Lund, *Nonvoting Shares and Efficient Corporate Governance*, 71 STAN. L. REV. 687, 692 (2019) [hereinafter Lund, *Nonvoting Shares*].

[201] *See, e.g.*, Ronald C. Anderson, Ezgi Ottolenghi & David M. Reeb, *The Dual Class Premium: A Family Affair* (Fox Sch. of Bus., Research Paper No. 17-021, 2017), https://ssrn.com/abstract=3006669 (finding that dual-class family firms yield excess stock returns of nearly 350 basis points per year); Scott W. Bauguess, Myron B. Slovin & Marie E. Sushka,

pressure from the CII, as well as other major mutual fund providers, who were concerned about the erosion of shareholder rights in the wake of Snap Inc.'s controversial public offering.[202] And this example therefore reveals that when index providers take a stand on governance issues, they are likely to supply another source of pressure in favor of their client shareholders' interests.

7. Ratings Agencies

A credit rating agency is an organization that rates companies and their securities on a scale in exchange for a fee.[203] They are substantial drivers of demand for company debt and equity products because many institutional investors are limited to purchasing investment-grade products.[204] In addition, investors generally view credit ratings as a reflection of the health of the underlying company.[205] Therefore, the models used by credit ratings providers can be quite influential.

All three major credit ratings providers—Moody's, Fitch Ratings, and S&P, integrate "good governance" criteria into their rating models.[206] A study of the corporate governance methodology used by these and two other ratings agencies found that a principal rating factor is the extent to which the company protects shareholder rights and aligns management and shareholder interests.[207] This is particularly surprising in light of the fact that creditor and shareholder interests often diverge.[208] In addition, several credit ratings providers also offer governance grades for companies to purchase.[209] For example, Morningstar grades companies based on "shareholder friendliness," "transparency," and a third category that asks whether firms have "consistently treated shareholders with respect."[210]

Beyond credit ratings providers, other market players offer assessments of the governance quality of an organization to aid institutional investors in their purchasing and voting decisions. For the past twenty years, the proxy advisor ISS has provided company governance ratings for a fee. These ratings have undergone several name changes, but are known today as the "ISS

Large Shareholder Diversification, Corporate Risk Taking, and the Benefits of Changing to Differential Voting Rights, 36 J. BANKING & FIN. 1244, 1244–46 (2012) (finding superior industry-adjusted performance in connection with a change to differential voting rights and sale of insider economic interests); Valentin Dimitrov & Prem C. Jain, *Recapitalization of One Class of Common Stock into Dual-Class: Growth and Long-Run Stock Returns*, 12 J. CORP. FIN. 342, 346–47 (2006) (suggesting that dual-class structures might enhance value).

202 Lund, *Nonvoting Shares*, *supra* note 200, at 691.

203 *See* Caitlin M. Mulligan, *From AAA to F: How the Credit Rating Agencies Failed America and What Can be Done to Protect Investors*, 50 B.C. L. REV. 1275, 1279 (2009); *see also* Frank Partnoy, *What's (Still) Wrong with Credit Ratings*, 92 WASH. L. REV. 1407, 1410 (2017). Research analysts serve a similar function, issuing earnings projections and providing company ratings for a fee. These analyst projections provide another source of pressure on management to maximize shareholder wealth. James Park, *From Managers to Markets: Valuation and the Shareholder Wealth Paradigm*, UCLA School of Law, Law-Econ Research Paper No. 20-09 (Nov. 17, 2020). https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3731764.

204 *See* Mulligan, *supra* note 203.

205 *Id.*

206 Amir Louizi & Radhouane Kammoun, *Evaluation of Corporate Governance Systems by Credit Rating Agencies*, 20 J. MGMT. & GOVERNANCE 363 (2016).

207 *Id.*

208 *See, e.g.*, Rock, *supra* note 79.

209 *Id.* Ratings agencies have also started to provide ESG ratings. Billy Nauman, *Credit Rating Agencies Join Battle for ESG Supremacy*, FIN. TIMES (Sept. 16, 2019), https://www.ft.com/content/59f60306-d671-11e9-8367-807ebd53ab77.

210 Paul Rose, *The Corporate Governance Industry*, 32 J. CORP. L. 101, 119 (2007); *see also Stewardship Grades*, MORNINGSTAR, https://www.morningstar.com/InvGlossary/stewardship_grade.aspx (last visited Jan. 25, 2021).

Governance Quickscore."[211] On the first day of trading of each month, ISS announces updated scores based on four categories: board, audit, shareholder rights, and compensation. In each category, the company receives points for responsiveness to shareholders.[212] Stakeholders, by contrast, are neglected: Only once in the 121-page scoring report are stakeholders mentioned at all—in a section on accounting restatements that "pose a material risk to shareholders and/or stakeholders."[213]

There is evidence that these governance ratings, like credit ratings, substantially affect trading decisions—a recent study determined that a Quickscore downgrade by ISS has a large negative impact on stock returns.[214] In other words, a company that wants to avoid a negative governance score and corresponding repercussions would do well to adhere to the governance guidelines adopted by ISS.[215] Therefore, these market forces provide an additional source of pressure on companies to advance shareholder interests.

C. Culture

Culture, the final component of the corporate governance machine, may be the most influential of all. Although highly contestable and notoriously hard to pin down, culture has been defined as "the total shared, learned behavior of a society or a subgroup."[216] Nobel-Prize winner Oliver Williamson's model of social analysis puts culture at the very top, at the level of "social embeddedness."[217] He observes that change at this level happens slowly, and that culture has a pervasive influence on the levels below, including those that include legal rules and company governance structures.[218] Comparative corporate governance scholars have similarly observed the important interaction between culture and law.[219] In particular, these scholars have noted the particular influence of culture to drive choice of legal rules and corporate ownership structures.[220]

---

211 *ISS Governance QuickScore*, ISS, https://www.issgovernance.com/iss-governance-quickscore-factset-users/ (last visited Jan. 25, 2021).
212 *Id.*
213 *Id.* at 65.
214 Paul M. Guest & Marco Nerino, *Do Corporate Governance Ratings Change Investor Expectations? Evidence from Announcements by Institutional Shareholder Services*, REV. FIN (forthcoming) (manuscript at 4), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3464395 (find that "rating downgrades by ISS cause negative announcement returns of –1.14%").
215 Academics have also created influential indices that gauge governance quality, again, with a focus on shareholders as the defining feature of good governance. These include the Gompers, Ishii and Metrick G index and the Bebchuk, Cohen and Ferrell E index. Merritt B. Fox, Ronald J. Gilson & Darius Palia, *The Core Corporate Governance Puzzle: Contextualizing the Link to Performance*, 99 B.U. L. REV. 1995, 2034 (2019).
216 Margaret Meade, *The Study of Culture at a Distance*, *in* THE STUDY OF CULTURE AT A DISTANCE 22 (M. Mead & R. Metreaux eds., 1953).
217 Oliver E. Williamson, *The New Institutional Economics: Taking Stock, Looking Ahead*, 38 J. ECON. LIT. 595 (2000).
218 *Id.*
219 *See, e.g.*, Amir N. Licht, *Culture and Law in Corporate Governance*, *in* THE OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE (Jeffrey N. Gordon & Wolf-Georg Ringe eds., 2018); Amir N. Licht & Renée Adams, *Shareholders and Stakeholders around the World: The Role of Values, Culture and Law in Directors' Decisions* (ECGI Law, Working Paper No. 459/2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3407873.
220 *See, e.g.*, Lucian Arye Bebchuk & Mark J. Roe, *A Theory of Path Dependence in Corporate Governance and Ownership*, 52 STAN. L. REV. 127, 168 (1999); Rene M. Stulz & Rohan Williamson, *Culture, Openness, and Finance*, 70 J. FIN. ECON. 313 (2003); Amir N. Licht, Chanan Goldschmidt & Shalom H. Schwartz, *Culture, Law, and Corporate Governance*, 25 INTL. REV. L. & ECON. 229 (2005).

Many informal affiliations and institutions are responsible for transmitting the culture of corporate governance in the United States, but we focus on three—professional education, the media, and political associations.[221] As the following subsections reveal, each institution has contributed to establishing shareholder primacy as the guiding norm for fiduciary conduct.

1. Professional Education

Academic institutions, and business and law schools in particular, influence how future corporate fiduciaries perceive their roles. For the past few decades, these institutions have imparted the view that increasing shareholder value is the chief business objective. Although it has not gone unchallenged, shareholder value "is the leitmotif of finance teaching and implicit throughout the rest of the curriculum" at most business schools.[222] In addition, legal nuances have often been lost in translation, as shareholder primacy is often reduced to a message of maximizing short-term stock price.[223]

Researchers pinpoint this shift starting in the 1970s, with a generation of business school students who were enamored with Milton Friedman's philosophy that managers should focus on shareholder wealth maximization.[224] Within a decade, business schools that had "been preaching something very different since their founding days" turned toward shareholder capitalism.[225] As a telling example, Harvard Business School hired Michael Jensen, an early proponent of the view that minimizing agency costs between shareholders and management was a key goal of corporate governance.[226] Jensen incorporated agency theory into the some of the most popular courses in the curriculum and minimized the previously dominant model that emphasized managerial discretion.[227] Others followed this approach and leading finance texts began to present shareholder

---

[221] For a broader investigation of the influence of culture on corporate governance, see Licht et al., *supra* note 220.

[222] N. Craig Smith & Luk Van Wassenhove, *How Business Schools Lost Their Way*, BLOOMBERG (Jan. 11, 2010, 9:19 AM), https://www.bloomberg.com/news/articles/2010-01-11/how-business-schools-lost-their-way; MAYER, *supra* note 1, at 2 (noting that the "Friedman doctrine" of shareholder wealth maximization "has been the basis of business education that has moulded generations of business leaders").

[223] *See* Rock, *supra* note 5 (manuscript at 21) ("While lawyers, judges and law professors would all explain that interpreting *Revlon* as requiring that boards maximize short term stock price is a badly inaccurate description, many directors apparently believe it anyway."); *see also* Eduardo Porter, *Motivating Corporations to Do Good*, N.Y. TIMES (July 15, 2014), https://www.nytimes.com/2014/07/16/business/the-do-good-corporation.html ("Though legally dubious, the argument that it is an executive's fiduciary duty to maximize the company's share price became a mantra from the business school to the boardroom.").

[224] DUFF MCDONALD, THE GOLDEN PASSPORT: HARVARD BUSINESS SCHOOL, THE LIMITS OF CAPITALISM, AND THE MORAL FAILURE OF THE MBA ELITE 357, 361–62 (2017).

[225] *Id.* at 367; David Ronnegard & N. Craig Smith, *Shareholder Primacy, Corporate Social Responsibility, and the Role of Business Schools*, 134 J. BUS. ETHICS 463, 471–73 (2016); *cf.* EELLS, *supra* note 23, at vii (arguing in the 1960s that business schools should teach the "governance of corporations" so the "top business leaders of tomorrow will become managerial statesmen to the degree that they conceive of their task in larger terms than efficient administration for production alone and accept their responsibilities as officers of private governmental systems"). A similar transformation occurred in law schools. Alexander Styhre, *The Making of the Shareholder Primacy Governance Model: Price Theory, the Law and Economics School, and Corporate Law Retrenchment Advocacy*, 8 ACCOUNT. ECON. & L., issue 3 (2017), https://www.degruyter.com/view/journals/ael/8/3/article-20160021.xml.

[226] *See supra* notes 45–48 and accompanying text; *see also* Brian R. Cheffins, *What Jensen and Meckling Really Said About the Public Company*, *in* RESEARCH HANDBOOK ON CORPORATE PURPOSE AND PERSONHOOD (Elizabeth Pollman & Robert B. Thompson, forthcoming 2021) (tracing Jensen's work and views).

[227] MCDONALD, *supra* note 224, at 367.

value maximization as the widely accepted understanding of corporate purpose.[228] This educational focus became pervasive: a 2011 study of top law and business schools found that classes that teach the purpose of the corporation emphasize the goal of maximizing shareholder value.[229]

Not only that, around the same time, scholars in law and finance began to use event studies of stock price reactions to evaluate governance reform.[230] This development further entrenched the shareholder wealth maximization norm because a governance practice would be deemed value-enhancing only if it boosted the company's share price. And scholars passed down these tenets to future business executives, who learned that governance quality is closely tied to shareholder value, and profit-maximization in particular.[231]

Professional education has served a potent avenue of social transmission: Studies show that when students enter business school, they tend to believe that the purpose of a corporation is to produce goods and services for the benefit of society, but by the time they graduate, they are more likely to believe its purpose is to maximize shareholder value.[232] These graduates in business and law go on to run and advise U.S. public corporations, from the top leadership position down to the newest hire. As such, the norms passed along in graduate education are enormously influential in corporate decisionmaking.[233]

2. Media

The media has also played an important role in propelling the shareholder primacy view forward. To take a famous example, the *New York Times Magazine* selected for publication Milton Friedman's 1970 essay, which is often credited with catalyzing the shareholder primacy movement.[234] In the decades that followed, hostile acquirers battled the press who labeled them "corporate raiders" who bled the economy.[235] Academics and other shareholder primacy

---

228 *See, e.g.*, RICHARD A. BREALEY, STEWART C. MYERS, & FRANKLIN ALLEN, PRINCIPLES OF CORPORATE FINANCE 9 (10th ed. 2011) ("The goal of maximizing shareholder value is widely accepted in both theory and practice.").

229 Darrell West, *The Purpose of the Corporation in Business and Law School Curricula*, BROOKINGS 2, 14 (July 19, 2011), https://www.brookings.edu/research/the-purpose-of-the-corporation-in-business-and-law-school-curricula/(finding that in a survey of the "top 20 business and top 20 law schools as rated by media publications," students viewed "maximizing shareholder value" as the highest responsibility of a company).

230 *See, e.g.*, Sanjai Bhagat & Roberta Romano, *Event Studies and the Law, Part II: Empirical Studies of Corporate Law*, 4 AM. L. ECON. REV. 380 (2002) (explaining "the goal of corporate law is to increase shareholder wealth, and event studies provide a metric for measurement of the impact upon stock prices of policy decisions"); *see also* Robert Bartlett & Frank Partnoy, *The Misuse of Tobin's* q, 73 VAND. L. REV. 353, 406 (2020) (discussing "the growing use and reliance on Simple *q* as a proxy for firm value" and how it has been used in "a large body of empirical scholarship" to "draw conclusions about what constitutes 'good' versus 'bad' corporate governance").

231 *See, e.g.*, RAKESH KHURANA, FROM HIGHER AIMS TO HIRED HANDS: THE SOCIAL TRANSFORMATION OF AMERICAN BUSINESS SCHOOLS AND THE UNFULFILLED PROMISE OF MANAGEMENT AS PROFESSION 364 (2007) ("[B]usiness school professors instructed thousands of students and executives on how to use financial engineering tools, like leverage and stock options, to align corporate actions with the goal of maximizing shareholder value.").

232 MCDONALD, *supra* note 224, at 370.

233 *Id.* at 3 ("If schools emphasize a particular set of values or approaches, it will reverberate for decades to come."); *see generally* NEIL FLIGSTEIN & DOUG MCADAM, A THEORY OF FIELDS 79–80 (2012) (theorizing social change and identifying "higher education and professionals" as key influencers).

234 Aaron Brown, *Shareholder Primacy Means Shareholders Are Paid Last*, BLOOMBERG (Sept. 5, 2019, 10:00 AM), https://www.bloomberg.com/opinion/articles/2019-09-05/shareholder-primacy-means-shareholders-are-paid-last.

235 *See, e.g.*, Leonard Silk, *The Peril Behind the Takeover Boom*, N.Y. TIMES, Dec. 29, 1985, § 3, at 1, https://www.nytimes.com/1985/12/29/business/the-peril-behind-the-takeover-boom.html.

proponents, however, countered these early reactions by advancing the "agency costs" view that takeovers disciplined wayward management and created shareholder value, with a beneficial effect on the economy.[236] This narrative ultimately seeped into mainstream coverage, which evolved to evaluate corporate actions in terms of whether they are value-creating for shareholders.

As broader evidence of shareholder primacy's stronghold, consider how the media generally focuses on short-term stock market movements not just as evidence of management's capabilities, but also of the health of the overall economy. To take a recent example, during the Covid-19 pandemic, news articles covered the peaks and troughs in the stock market as a sign of the country's economic outlook, despite signs of divergence.[237] The media's focus on share price and market performance is likely explained by the same intuitive simplicity that has resulted in shareholder primacy's lasting power elsewhere. As Lynn Stout explained, "To the popular press and business media, shareholder primacy offered an easy-to-explain, sound-bite description of what corporations are and what they are supposed to do. To businesspeople and reformers seeking a way to distinguish between good and bad governance practices, the shareholder-centric view promised a single, easily-read measure of corporate performance in the form of share price."[238]

In short, the language of shareholder primacy gave the business press an easily accessible frame to weigh in on company management via comparisons to a simple lodestar—shareholder value, and specifically, share price maximization.[239] That is not to say that all media coverage has favored shareholders, but that over time, the cultural acceptance of shareholder primacy as a desirable objective for the firm has bled into business reporting that appears neutral, but in reality, embeds many assumptions about the proper corporate objective.

3. Politics

Finally, corporate governance reflects the political environment.[240] There are no universal principles of how politics align with issues of corporate governance, but scholars have identified some interesting patterns. In general, shareholder primacy has its roots in right-of-center thinking, whereas stakeholder models are embraced by politicians on the left side of the aisle.[241] Nonetheless, in the United States, both groups increasingly converged on shareholder primacy over the past two decades: as labor and pension funds used their growing governance power to advance their political

---

[236] *See, e.g.*, Michael C. Jensen, *Takeovers: Folklore & Science*, HARV. BUS. REV., Nov. 1984, https://hbr.org/1984/11/takeovers-folklore-and-science.

[237] *See, e.g.*, Greg Rosaly, *What Is the Stock Market Trying to Tell Us?*, NPR (June 16, 2020, 6:30 AM), https://www.npr.org/sections/money/2020/06/16/877410547/what-is-the-stock-market-trying-to-tell-us ("Economists consider the stock market a 'leading indicator' of the economy, meaning it often signals where the real economy is headed.").

[238] Stout, *New Thinking*, *supra* note 67, at 3.

[239] *Id.*

[240] *See, e.g.*, MARK J. ROE, POLITICAL DETERMINANTS OF CORPORATE GOVERNANCE: POLITICAL CONTEXT, CORPORATE IMPACT 4 (2003) (observing the incidence of hostile takeovers, proxy fights, and incentive-based compensation are determined by "nation-by-nation specifics").

[241] Bruner, *supra* note 95, at 267; Stephen M. Bainbridge, *Community and Statism: A Conservative Contractarian Critique of Progressive Corporate Law Scholarship*, 82 CORNELL L. REV. 856, 857–58 (1997). For a discussion of how state corporate law can engender partisan politics, and Delaware has used a perceived nonpartisan approach to its strategic advantage, see Ofer Eldar & Gabriel Rauterberg, Is Corporate Law Nonpartisan? (unpublished manuscript) (on file with authors).

interests,[242] left-of-center politicians embraced the expansion of shareholder rights.[243] This trend solidified after the Enron accounting scandal and the financial crisis, which sparked criticism of ineffective monitoring mechanisms and a lack of managerial accountability to shareholder interests.[244] In the wake of these crises, liberal and conservative politicians united in passing corporate governance reform that strengthened shareholder power,[245] and incorporated additional mechanisms to ensure that management prioritized shareholder interests.[246]

Another reason for this convergence is the shift from defined benefit to defined contribution retirement plans that rendered millions of working Americans forced investors in the stock market.[247] As discussed in the previous Section, this trend has increased the power and influence of institutional investors who wield the governance rights of American workers. It has also entrenched shareholder primacy across both sides of the political aisle: elected officials understand that shareholder value creation affects not only the wealthiest one percent, but also the millions of Americans who are investors through their pension funds and 401(k) accounts.[248] Moreover, the "rhetoric of shareholder value" is politically powerful when "the interests and perceptions of the investor class [are] viewed, however questionably, as largely coterminous with those of the citizenry at large."[249] This framing helps at times to forge alliances at the national level between financial and labor interests, supporting governmental responses ranging from enacting shareholder-focused corporate governance legislation to buttressing large corporations and securities markets.[250]

* * *

From professional education and the media to politics, cultural elements work together to perpetuate shareholder primacy as the governing norm in the United States. The lack of global convergence toward a shareholder primacy model suggests that the orientation of the corporate

---

242 Romano, *Public Pension Fund Activism*, *supra* note 140.

243 *See* Bruner, *supra* note 95, at 286 ("Since the turn of the millennium, shareholder-centric corporate governance reforms at the federal level have picked up pace, and such reforms have uniformly emerged from the political left."); William W. Bratton & Michael L. Wachter, *Shareholders and Social Welfare*, 36 SEATTLE U. L. REV. 489, 513–14 (2013) (describing the "progressive overlay" of shareholder politics and the shared interests between labor and equity).

244 Mirela V. Hristova, *Dodd-Frank's Corporate Governance Reform*, 30 REV. BANKING & FIN. L. 516, 517 (2011).

245 *Id.* at 519–26 (detailing Dodd-Frank's attempts to promote increased accountability).

246 *See* Charles Elson & Christopher Gyves, *The Enron Failure and Corporate Governance Reform*, 38 WAKE FOREST L. REV. 855 (2003). For an argument that rising populist sentiment is unlikely to result in significant change in the law of corporate purpose, see Stephen M. Bainbridge, *Corporate Purpose in a Populist Era*, 98 NEB. L. REV. 543, 577 (2019).

247 *See* Gilson & Gordon, *supra* note 79, at 881–82 (discussing how the rise of defined contribution plans increased the incidence of shareholding by ordinary Americans).

248 Bruner, *supra* note 95, at 267; Martin Gelter, *The Pension System and the Rise of Shareholder Primacy*, 43 SETON HALL L. REV. 909, 911 (2013) (arguing that "changes in the pension system helped to transform corporate governance into a system dominated by the shareholder interest").

249 JOHN W. CIOFFI, PUBLIC LAW AND PRIVATE POWER: CORPORATE GOVERNANCE REFORM IN THE AGE OF FINANCE CAPITALISM 110–16 (2010).

250 *See* Bruner *supra* note 95, at 322–24 (describing the "coalition of financial and labor interests" that "allies shareholders and employees against management" and ties the framing to "interests and perceived vulnerabilities of the 'middle class'" to catalyze passage of legislation such as SOX and Dodd-Frank); Matt Phillips, *Too Big to Fail: The Entire Private Sector*, N.Y. TIMES (May 19, 2020), https://www.nytimes.com/2020/05/19/business/too-big-to-fail-wall-street-businesses.html ("In a bid to soften the coronavirus's economic blow, the government has stretched its financial safety net wide—from strategically sensitive companies, to entire industries such as energy and airlines, to the market for corporate bonds."); David T. Zaring, The Government's Economic Response to the COVID-19 Crisis 4 (Aug. 7, 2020) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3662049 (describing the Federal Reserve Board and Treasury Department responses to "sustain the U.S. economy amidst the pandemic").

governance machine should not be taken for granted—culture appears to be a driving force. However, of all of the corporate governance machine's components, culture appears to be the most in flux. Academic institutions are increasingly coming under fire for teaching shareholder primacy at the exclusion of other viewpoints, and many are beginning to offer courses exploring sustainability, ESG, and stakeholder models.[251] Prominent scholars and professionals in business and law are likewise calling for change.[252] Norms have shifted quickly among S&P 500 companies toward voluntary reporting of social responsibility and sustainability efforts.[253] In turn, media outlets are increasingly observing a shift away from shareholder primacy is taking place.[254] And finally, political parties, both from the right and left, have begun to attack shareholder primacy and offer proposals for change.[255] It remains to be seen, however, whether cultural change can by itself manifest a shift away from shareholder primacy, and whether other elements of the corporate governance machine will eventually catch on.

III. HOW THE CORPORATE GOVERNANCE MACHINE WORKS

The previous Part identified the components of the corporate governance machine and hinted at their reinforcing nature. This Part builds on this foundation and demonstrates how the corporate governance machine operates to force certain changes on companies and governance reformers alike using three detailed examples: (1) public company boards of directors, (2) the ESG movement, and (3) the benefit corporation.

A. Public Company Boards

What is the function of the board of directors? At one point in time, corporate directors were envisioned as socially responsive trustees, helping management chart the right course of action for the company. Indeed, in the 1950s—the "heyday of managerial capitalism"—corporate boards were primarily composed of corporate insiders, with a sprinkling of outsiders with a variety of economic relationships with the company.[256] There was also a concerted effort to *not* align boards solely with shareholder interests as doing so "would undercut the desirable capacity of managers to manage in the public interest."[257]

---

[251] Alternative management perspectives have also gained influence. *See, e.g.*, Michael E. Porter & Mark R. Kramer, *Creating Shared Value*, HARV. BUS. REV., Jan.-Feb. 2011, https://hbr.org/2011/01/the-big-idea-creating-shared-value.
[252] *See, e.g.*, Berger, *supra* note 143, at 662 ("There is now growing recognition that the model of stockholder primacy is no longer acceptable, and that corporations must focus on broader corporate purposes, beyond stockholder value.").
[253] Governance & Accountability Inst., Inc., 86% of S&P 500 Index Companies Publish Sustainability/Responsibility Reports in 2018 (May 16, 2019), https://www.ga-institute.com/press-releases/article/flash-report-86-of-sp-500-indexR-companies-publish-sustainability-responsibility-reports-in-20.html.
[254] *See, e.g.*, Alan Murray & David Meyer, *The End of Shareholder Primacy*, FORTUNE (Aug. 19, 2019, 3:22 AM), https://fortune.com/2019/08/19/the-end-of-shareholder-primacy-ceo-daily/ (arguing that the shareholder primacy model has been "scrapped"); Steve Denning, *Why Maximizing Shareholder Value Is Finally Dying*, FORBES (Aug. 19, 2019, 6:06 PM), https://www.forbes.com/sites/stevedenning/2019/08/19/why-maximizing-shareholder-value-is-finally-dying/#54252e166746 (observing the media "hubbub" around the Business Roundtable's embrace of stakeholders); Moral Money, FIN. TIMES, https://www.ft.com/moral-money (bi-weekly newsletter on "the fast-expanding world of socially responsible business . . . and (ESG) trends").
[255] *See, e.g.*, *supra* note 2 and accompanying text.
[256] Jeffrey N. Gordon, *The Rise of Independent Directors in the United States, 1950-2005: Of Shareholder Value and Stock Market Prices*, 59 STAN. L. REV. 1465, 1513 (2007).
[257] *Id.* at 1514.

In the 1970s, things changed. A series of corporate scandals, discussed in Part I, brought to light how passively boards discharged their duties, leading to a revisiting of the board's function.[258] Combined with early literature in law and economics, the board's role became to "constrain managerial opportunism" and minimize the agency problem created by the separation of ownership and control.[259]

This "monitoring" model took off. The American Law Institute endorsed the monitoring function in its draft Principles of Corporate Governance, which suggested that at least a majority of the board should be independent directors.[260] This endorsement was not without controversy, however—the Principles project was drawn out, and "resembled the rough-and-tumble politics of a state legislature."[261] But over time, the monitoring model won out, as legal and market players continued to push for board independence. For example, around the same time that the ALI finalized its Principles, the Chairman of the SEC and the ABA Committee on Corporate Laws both embraced the view that the chief function of the board is to monitor management for the benefit of shareholders.[262] The hostile takeover wave of the 1980s further solidified this development, as pursuit of shareholder value became the all-encompassing guide for corporate behavior.[263]

From then on, legal reform of the board of directors took a predictable tack. For example, the collapse of Enron and WorldCom led multiple players within the corporate governance machine to adopt more stringent independence requirements for directors. Although the root cause of these collapses were accounting failures, reformers blamed corporate boards for failing to stop managers from eroding gatekeeper integrity.[264] In response, the NYSE convened a corporate governance task force that generated strict director independence requirements as a precondition to being listed.[265] Shortly thereafter, Congress adopted the Sarbanes-Oxley Act of 2002, which required the SEC to prohibit U.S. stock exchanges from listing securities unless the company had an audit committee composed solely of independent directors.[266]

On top of this legal reform, proxy advisors ratcheted up pressure on corporate boards to increase board independence. For example, ISS's 2019 voting guidelines state: "Boards should be sufficiently independent from management . . . to ensure that they are able and motivated to effectively supervise management's performance for the benefit of all shareholders."[267] ISS enforces these policies by committing to recommend voting against insider directors when

---

[258] *See id.*
[259] *Id.* at 250.
[260] STEPHEN M. BAINBRIDGE, THE NEW CORPORATE GOVERNANCE IN THEORY AND PRACTICE 160 (2008).
[261] Stephen M. Bainbridge, *Independent Directors and the ALI Corporate Governance Project*, 61 GEO. WASH. L. REV. 1034, 1044 (1993).
[262] *See* Roderick Hills, Chairman, SEC, Corporate Rights and Responsibilities Hearings Before the S. Comm. on Commerce, 94th Cong. (1976); ABA Comm. on Corporate Laws, *Corporate Director's Guidebook*, 33 BUS. LAW. 1591, 1619–20 (1978) ("[T]he board of directors is [the] reviewer of management initiatives and monitor of corporate performance . . . .").
[263] Gordon, *supra* note 256, at 1528, 1540.
[264] *Id.* at 1539.
[265] *Id.*; NYSE Listed Company Manual § 303 (amended July 18, 2019).
[266] *Audit Committees & Auditor Independence*, SEC, https://www.sec.gov/info/accountants/audit042707.htm (last modified May 7, 2007).
[267] ISS, UNITED STATES PROXY VOTING GUIDELINES BENCHMARK POLICY RECOMMENDATIONS 8 (Nov. 18, 2019), https://www.issgovernance.com/file/policy/active/americas/US-Voting-Guidelines.pdf.

independent directors make up less than fifty percent of the board or an insider director serves on the audit, compensation, or nominating committees.[268]

These legal and extra-legal changes led to a dramatic shift in board composition. From 1950 to the mid-2000s, the fraction of independent directors on large U.S. public company boards increased from approximately 20% to 75%.[269] That is so despite the fact that there is far from universal consensus that director independence leads to better board decisionmaking and oversight.[270] Yet the corporate governance machine pushed for this result. Specifically, after ideas wrought in academia led to an evolving cultural understanding of corporate governance, major institutional players—including the SEC, the stock exchanges, and influential proxy advisors—adopted rules that brought the monitoring model into the mainstream. By force of these developments, all U.S. public company corporate boards have a significant percentage of independent directors, and view their role as safeguarding the interests of shareholders.

B. The ESG Movement

Our next example begins in the Great Depression, when Professors Adolf Berle and Merrick Dodd famously debated corporate purpose. Berle's view was that managers should exercise power "only for the ratable benefit of all the shareholders,"[271] while Dodd argued that the corporation "has a social service as well as a profit-making function."[272] In the wake of that debate, Dodd appeared to be the victor.[273] During the mid-twentieth century period of managerial capitalism, corporate charitable giving became accepted practice and corporate managers acknowledged that businesses had social obligations. In the 1950s, economist Howard Bowen coined the term "corporate social responsibility" out of a concern for corporate power and its impact on society.[274] His view was squarely aligned with Dodd's: he defined the social responsibilities of management as "the obligations of businessmen to pursue those policies, to make those decisions, or to follow those lines of action which are desirable in terms of the objectives and values of our society."[275]

---

[268] *Id.*

[269] Gordon, *supra* note 256, at 1471.

[270] Stephen M. Bainbridge, *A Critique of the NYSE's Director Independence Listing Standards* 1–2 (UCLA Sch. of L., Research Paper No. 02-15, 2002), http://fedsoc.server326.com/pdf/NYSEStandards.pdf (describing the NYSE's proposals for increased director independence as "the warmed-over rejects of past corporate governance 'reform' initiatives"); Sanjai Bhagat & Bernard Black, *The Uncertain Relationship Between Board Composition and Firm Performance*, 54 BUS. LAW. 921 (1999) (finding no correlation between greater board independence and profitability or growth); Lisa M. Fairfax, *The Uneasy Case for the Inside Director*, 96 IOWA L. REV. 127, 193 (2010) (arguing that "reliance on independent directors has been inappropriately used to substitute for rigorous external regulation"); Ronald J. Gilson & Jeffrey N. Gordon, *Board 3.0: An Introduction*, 74 BUS. LAW. 351, 351–54 (2019) (arguing the dominant "monitoring board" of independent directors has "fallen short" and should be replaced with a new model of "thickly informed, well-resourced, and highly motivated directors").

[271] A.A. Berle, Jr., *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049, 1049 (1931).

[272] E. Merrick Dodd, Jr., *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145, 1148 (1932).

[273] Berle conceded as much. *See* ADOLF A. BERLE, JR., THE 20TH CENTURY CAPITALIST REVOLUTION 169 (1954) (acknowledging the debate "ha[d] been settled (at least for the time being) squarely in favor of Professor Dodd's contention").

[274] HOWARD R. BOWEN, SOCIAL RESPONSIBILITIES OF THE BUSINESSMAN (1953).

[275] Elizabeth Pollman, *Corporate Social Responsibility, ESG, and Compliance*, *in* CAMBRIDGE HANDBOOK OF COMPLIANCE (D. Daniel Sokol & Benjamin van Rooij eds., forthcoming 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3479723; *see also* Ming-Dong Paul Lee, *A Review of the Theories of Corporate Social Responsibility: Its Evolutionary Path and the Road Ahead*, 10 INT'L J. MGMT. REVS. 53 (2008).

This view persisted in mainstream thinking for several decades. However, as in our previous example, much changed in the 1970s. Increasing adherence to the perspective famously espoused by Milton Friedman—that a company's responsibility is to maximize shareholder profit—corresponded with a marginalization of corporate social responsibility and a new direction in research. This started with scholars in the 1980s who began to discuss corporate social responsibility as a decisionmaking process and explore how it could be operationalized through various frameworks, models, and evaluation methods.[276] And these models eventually began to rely on the link between corporate social responsibility and financial performance.[277]

By the early 2000s, researchers continued to explore the link between CSR and financial performance, accruing evidence of the "business case" for CSR. This led to a cultural shift—CSR was not bad for business, but good; therefore, the obligation to engage in CSR was part and parcel of management's duties to its shareholders. Around this time, CSR was largely recast as ESG and therefore inextricably linked with governance. The term ESG was coined by the United Nations following its 2005 conference "Who Cares Wins," which brought together institutional investors, financial analysts, consultants, and regulators.[278] The report that followed made the case that integrating ESG factors into corporate and investor decisionmaking was critical for the security of investments, prosperity, and growing markets.[279] Shortly after, in collaboration with an international group representing institutional investors, the United Nations launched at the New York Stock Exchange the "Principles for Responsible Investment," promoting the integration of ESG issues within the investment industry.[280]

Many players in the corporate governance system embraced this move and solidified it. First, the move to value-enhancing ESG was squarely consistent with the law in Delaware. Even scholars who advance a shareholder primacy view have agreed that boards of directors have significant discretion in nearly all circumstances to exercise their business judgment and that pursuing stakeholder interests can create value. Thus, value-enhancing ESG thread the needle in terms of legal debates and was supported by the legal community. And although the move to value-enhancing ESG arguably narrowed the range of public-minded activities that companies might pursue, CSR advocates may have been willing to accept the ESG movement, as previous efforts to change corporate behavior had made limited inroads. In other words, in a world anchored to shareholder primacy, advocates of corporate social responsibility may have realized that many

---

[276] *See, e.g.*, Mauricio Agudelo et al., *A Literature Review of the History and Evolution of Corporate Social Responsibility*, 4 INT. J. CORP. SOC. RESP. 1, 7 (2019) (citing Thomas M. Jones, *Corporate Social Responsibility Revisited*, 22 CAL. MGMT. REV. 59 (1980)) (noting that Jones was the "first author to consider CSR as a decision making process that influence[s] corporate behavior").

[277] Frank Tuzzolino & Barry R. Armandi, *A Need-Hierarchy Framework for Assessing Corporate Social Responsibility*, 6 ACAD. MGMT. REV. 21 (1981) (assessing CSR based on profitability); Philip L. Cochran & Robert A. Wood, *Corporate Social Responsibility and Financial Performance*, 27 ACAD. MGMT. J. 42 (1984) (using a reputation index to explore the link between CSR and financial performance).

[278] UNITED NATIONS GLOB. COMPACT, INVESTING FOR LONG-TERM VALUE: INTEGRATING ENVIRONMENTAL, SOCIAL AND GOVERNANCE VALUE DRIVERS IN ASSET MANAGEMENT AND FINANCIAL RESEARCH (2005), https://missioninvestors.org/resources/investing-long-term-value-who-cares-wins-2005-conference-report.

[279] *Id.* at iii.

[280] *About the PRI*, PRINCIPLES FOR RESPONSIBLE INV., https://www.unpri.org/about-the-pri (last visited Jan. 25, 2021); Harper Ho, *"Enlightened Shareholder Value," supra* note 9, at 81–82 (describing the PRI). Around this time, the United Nations also launched the Principles for Responsible Investment and the Sustainable Stock Exchanges Initiative. *Who We Are*, SUSTAINABLE STOCK EXCHS. INITIATIVE, https://sseinitiative.org/about/ (last visited Jan. 25, 2021).

lawmakers and legal advisors would only support reform that was framed as value-maximizing ESG.[281]

Second, market players ran with the concept. As investors started to accept the notion that integrating ESG measures could mitigate risk and create shareholder value,[282] institutional players realized they could supply metrics and other services for a fee. As a result, ratings agencies began providing ESG metrics, institutional investors offered ESG funds, and thousands of investment professionals billed themselves as "ESG analysts."[283] ESG became a business opportunity.

Third and finally, these changes may be sparking further cultural shift. As a sign of the general acceptance of value-enhancing ESG, consider that during the 2019 proxy season, more than half of the shareholder proposals brought involved ESG issues, including topics such as disclosing climate change risk and increasing board diversity.[284] These proposals are not only being brought more regularly, they are also more likely to result in favorable results for shareholder proponents, and specifically, an increased likelihood of voluntary withdrawal in favor of negotiated settlements and greater overall support for those proposals that go to a shareholder vote.[285] In other words, the evolution of corporate social responsibility into value-enhancing ESG has propelled it into the mainstream, as legal and market players no longer hinder but instead amplify these efforts. And this example reveals how the corporate governance machine took a concept that was unlinked from shareholders and, through law, markets, and culture, reshaped it, and in so doing, allowed it to thrive.

C. Benefit Corporations

To the extent a business wants to pursue profits and a social purpose that is *inconsistent* with shareholder wealth maximization, it now has a customized option: organize as a benefit corporation. This new form of business organization is a twenty-first century reflection of how the corporate governance machine has transformed corporate social responsibility into an entirely different form of corporation. Moreover, even the benefit corporation is subject to the forces of

---

[281] *See, e.g.*, BEATE SJÅFELL & CHRISTOPHER M. BRUNER, THE CAMBRIDGE HANDBOOK OF CORPORATE LAW 4 (2020) (distinguishing the "weak sustainability" view, which integrates ESG into the "mainstream" focus on long-term financial performance, from "strong sustainability" which "simply means actual sustainability").

[282] Virginia Harper Ho, *Risk-Related Activism: The Business Case for Monitoring Nonfinancial Risk*, 41 J. CORP. L. 647, 684–85 (2016); Gadinis & Miazad, *supra* note 12.

[283] Georg Kell, *The Remarkable Rise of ESG*, FORBES (July 11, 2018, 10:09 AM), https://www.forbes.com/sites/georgkell/2018/07/11/the-remarkable-rise-of-esg/#380058a81695 (noting that ESG is "now, quite literally, big business" with "multi-billion dollar economic consequences"); Joseph A. Hall & Betty M. Huber, *ESG in the US: Current State of Play and Key Considerations for Issuers*, *in* THE INTERNATIONAL COMPARATIVE LEGAL GUIDE TO: CORPORATE GOVERNANCE 23–30 (12th ed. 2019) (summarizing ESG raters and methodologies); Dana Brakman Reiser & Anne M. Tucker, *Buyer Beware: Variation and Opacity in ESG and ESG Index Funds*, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3440768 (describing ESG investment options).

[284] Gary Larkin, *On Governance: 2019 Proxy Season Was Huge for E&S Proposals*, CONF. BOARD (Sept. 9, 2019), https://conference-board.org/blog/environmental-social-governance/ES-Proposals-Proxy-Season; Hannah Orowitz & Brigid Rosati, *An Early Look at the 2020 Proxy Season*, HARV. L. SCH. F. ON CORP GOVERNANCE (June 10, 2020), https://corpgov.law.harvard.edu/2020/06/10/an-early-look-at-the-2020-proxy-season/.

[285] *See* Orowitz & Rosati, *supra* note 284; John D. Stoll, *This Proxy Season, It's Revenge of the Nurdles*, WALL ST. J. (Apr. 12, 2019), https://www.wsj.com/articles/this-proxy-season-its-revenge-of-the-nurdles-11555074005.

shareholder power, further demonstrating the stickiness of the machine's shareholderist orientation.

The benefit corporation concept has been decades in the making as partial legal measures along the way fell short.[286] During the 1980s wave of hostile takeovers, many states adopted constituency statutes designed to insulate a corporation's board of directors from breach of fiduciary duty suits for considering the impact of their decisions on stakeholders.[287] Practically speaking, however, the existence of constituency statutes has not made much difference in the governance of most traditional corporations. States such as Delaware and California, home to a majority of public corporations and venture-backed startups, never adopted such statutes. And, most significantly, constituency statutes are merely permissive and do not commit corporate boards to pursuing stakeholder interests.[288]

Against this background, corporate reformers decided to push for an alternative. Around the same time that corporate social responsibility was transformed into value-maximizing ESG, a non-profit corporation called B Lab pushed state legislatures across the country to add a new form of business organization to their corporate codes. B Lab emerged out of the social enterprise movement and, specifically, through the grassroots efforts of former classmates-turned-business partners who came to believe that shareholder primacy was fundamentally flawed.[289]

Their first initiative was to offer businesses the opportunity to apply for certification as a "B Corp," a standard they invented to denote that a company had scored highly on their self-created metrics for "good business" practices related to governance, workers, community, environment, and customers.[290] Subsequently, B Lab created model legislation for a new form of corporation designed to pursue profits as well as a social mission.[291] Key features of the benefit corporation model legislation include a social purpose expressly stated in the charter, fiduciary duties requiring directors to consider the effect of decisions on stakeholders other than shareholders, and regular reporting obligations on social purpose activity.[292] In many other respects, however, the benefit corporation model adopts features of the traditional corporation. For example, shareholders have the power to elect the board of directors and the right to sue to enforce fiduciary obligations; therefore, a benefit corporation's protection from the corporate governance machine is only as

---

[286] *See* Larry Hamermesh, Bart Houlahan, Rick Alexander & Dan Osusky, *A Conversation with B Lab*, 40 SEATTLE U. L. REV. 321, 329 (2017).

[287] *See* Brett McDonnell, *Corporate Constituency Statutes and Employee Governance*, 30 WM. MITCHELL L. REV. 1228, 1231 (2004).

[288] *See* Stephen M. Bainbridge, *Interpreting Nonshareholder Constituency Statutes*, 19 PEPP. L. REV. 971, n.86 (1992) (noting "that the legislatures saw the statutes as making only minor changes in the law"). Some influential commentators advocated interpreting constituency statutes to allow consideration of stakeholders only to the extent consistent with existing law, which they stated as requiring shareholder primacy. ABA Committee on Corporate Laws, *Other Constituencies Statutes: Potential for Confusion*, 45 BUS. LAW. 2253, 2269 (1990).

[289] Hamermesh et al., *supra* note 286, at 326.

[290] *Id.* at 326; *see also* Michael B. Dorff, *Assessing the Assessment: B Lab's Effort to Measure Companies' Benevolence*, 40 SEATTLE U. L. REV. 515 (2017).

[291] *Model Benefit Corporation Legislation*, B Lab, https://benefitcorp.net/sites/default/files/Model%20benefit%20corp%20legislation%20_4_17_17.pdf (Apr. 17, 2017).

[292] Brett H. McDonnell, *Benefit Corporations and Public Markets: First Experiments and Next Steps*, 40 SEATTLE U. L. REV. 717, 720 (2017).

strong as the long-term commitment of its shareholders to the stakeholder approach.[293] Notably, these social entrepreneurs did not attempt to change corporate governance from within the traditional corporate form—they understood from previous business experiences and corporate law advisors that shareholder primacy was deeply ingrained and they believed the path for change therefore lay outside of the existing structure.

In 2010, B Lab succeeded in persuading their first state, Maryland, to adopt benefit corporation legislation and expanded from there.[294] But naturally, as they continued their campaign, B Lab team had their sights focused on Delaware.[295] B Lab pitched the council of the Delaware Bar Association that recommends changes to the corporate code and the response was predictably skeptical—as one lawyer explained, "our initial reaction was that just sounds like this other constituency statute thing that we rejected years ago because we know how corporate law works."[296] When further pressed to consider such legislation, the council's task force came around to the view that even if not necessarily "the best model," it was within the spirit of Delaware's approach to allow for private ordering.[297] That is, the benefit corporation could be one choice among a menu of organizational options, with the traditional corporation remaining focused on shareholders and undisturbed in its prominence.

This understanding helped catapult adoption of the benefit corporation legislation to over thirty states, including Delaware, which adopted its own less stringent version.[298] As a matter of culture and politics, the idea of the benefit corporation gained rare bipartisan support as state legislators from different ends of the political spectrum supported either business as a force for social good or the freedom of entrepreneurs to engage in private ordering of their business affairs. Not only that, market players easily embraced a model that was aligned with shareholder value creation.[299] Ultimately, however, the success of the benefit corporation as a separate business form reinforces the corporate governance machine's directional focus on shareholder interests for the vast majority of companies.[300]

---

293 A small number of benefit corporations have gone public and in doing so have employed additional protections from outside shareholder interference, including antitakeover provisions and dual-class stock, that are generally disfavored by the corporate governance machine. *See* Ann Lipton, *Benefit Corporations Go Public*, BUS. L. PROF BLOG (July 18, 2020), https://lawprofessors.typepad.com/business_law/2020/07/benefit-corporations-go-public.html.

294 *See* Andrew Kassoy, *Maryland First State in Union to Pass Benefit Corporation Legislation*, CSRWIRE (Apr. 14, 2010, 10:57 AM), https://www.csrwire.com/press_releases/29332-Maryland-First-State-in-Union-to-Pass-Benefit-Corporation-Legislation. Currently, B Corporation legislation is enacted in thirty-six states, and is under consideration in an additional two. *B Corporation Tracker*, SOC. ENTER. TRACKER, https://socentlawtracker.org/#/bcorps (last visited Jan. 25, 2021).

295 Hamermesh et al., *supra* note 286, at 327.

296 *Id.*

297 *Id.* at 328.

298 *See* Alicia E. Plerhoples, *Delaware Public Benefit Corporations 90 Days Out: Who's Opting In?*, 14 U.C. DAVIS BUS. L.J. 247, 250 (2014) (noting Delaware's public benefit corporation statute is "less restrictive" than B Lab's model legislation); RICK ALEXANDER, BENEFIT CORPORATION LAW AND GOVERNANCE: PURSUING PROFIT WITH PURPOSE 87 (2017) (noting Delaware's public benefit corporation statute is "less rigid" and gives "the choice to veer from . . . shareholder primacy, without giving up the key elements of conventional governance" such as business judgment rule protection and "without imposing regulatory-like disclosure burdens").

299 Hamermesh et al., *supra* note 286, at 358 (describing how major proxy advisory firms and institutional investors were on board with the creation of B Lab to the extent it would "create [shareholder] value").

300 To date, approximately 3,000 benefit corporations have been formed in the United States, representing less than .05% of U.S. businesses. U.S. CENSUS BUREAU, 2016 ANNUAL SURVEY OF ENTREPRENEURS (2016),

IV. IMPLICATIONS AND FUTURE PATHS

The previous Parts provided a novel descriptive account of the system of corporate governance that has reigned in the U.S. over the past half century. We now turn to examining the broad implications of our analysis for multiple pressing debates in corporate law. We also reflect on what the existence of the corporate governance machine reveals about the future of corporate governance.

A. Shaping the Development of Corporate Regulation

In the United States, for over a half century, corporate reform has generally moved in one direction—toward advancing shareholder interests. Although there are counter-examples, the larger war has been won; indeed, even the rules restricting shareholder rights and powers are justified as benefitting them in aggregate. And our analysis provides an explanation for this arc: the corporate governance machine forcefully dictates that shareholders are the only proper ends of corporate decisionmaking.

We can observe the influence of the machine in contemporary advocacy for corporate governance reform. Consider, for example, the issue of ESG disclosures. Two prominent academics, Jill Fisch and Cynthia Williams, have recently urged the SEC to require ESG disclosures for public companies.[301] Rather than stating the request broadly in terms of disclosure that would benefit the public, Fisch and Williams contend instead that ESG disclosures reveal information that would be material to the *investing* public. This tendency to frame reform, and specifically, corporate disclosures, to meet shareholder needs strikes some as overly narrow.[302] Yet, as the above discussion reveals, it is a wise strategic move in our existing system that prioritizes investor interests. The SEC, for instance, has faced increasing calls for mandating climate-related disclosures. It has nonetheless maintained its status quo approach that emphasizes the materiality standard as the core disclosure focus, while slightly opening the door to change by welcoming "market participants" to assist the SEC in "better understanding how issuers and investors use environmental and climate-related information to make capital allocation decisions . . ."[303]

A similar pattern emerges in practice and soft law norms. For example, as voluntary ESG disclosure standards emerge and gain adherents, we see the flexible, shareholder-oriented SASB standards winning out in the United States, despite the fact that tougher, more stakeholder-oriented

---

https://www.census.gov/programs-surveys/ase/data/tables.html (estimating approximately 5.6 million employer firms in the US); *B Corps & Benefit Corporations*, URB. SUSTAINABILITY DIR.'S NETWORK, https://sustainableconsumption.usdn.org/initiatives-list/b-corps-and-benefit-corporations (last visited Jan. 25, 2021) (reporting 3,000 U.S. benefit corporations).

301 Cynthia A. Williams & Jill E. Fisch, *Petition to SEC for Rulemaking on Environmental, Social, and Governance (ESG) Disclosure*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Oct. 9, 2018), https://corpgov.law.harvard.edu/2018/10/09/petition-to-sec-for-rulemaking-on-environmental-social-and-governance-esg-disclosure/; *see also* Virginia Harper Ho, *Nonfinancial Disclosure & The Costs of Private Ordering*, 55 AM. BUS. L.J. 407, 413 (2018) (arguing that mandatory ESG disclosure would serve the SEC's mission of protecting investors, facilitating capital formation, and promoting fair, orderly, and efficient markets).

302 *See* Lipton, *supra* note 111.

303 SEC Chairman Jay Clayton, Statement on Proposed Amendments to Modernize and Enhance Financial Disclosures; Other Ongoing Disclosure Modernization Initiatives; Impact of the Coronavirus; Environmental and Climate-Related Disclosure (Jan. 30, 2020), https://www.sec.gov/news/public-statement/clayton-mda-2020-01-30.

GRI standards are popular elsewhere and have existed longer.[304] In turn, proxy advisors and ratings agencies have evolved to supply ESG metrics for corporations and investors.[305] These examples show that the machine is slowly moving in the direction of incorporating stakeholder interests, on the grounds that this is what investors want.[306] And this suggests that reform couched in these terms has a real chance of success.

Despite the widening lens, however, this advocacy ultimately reinforces the corporate governance machine's shareholderist orientation.[307] For one, the fact that legal reformers work within the language and conceptual framing of shareholder primacy solidifies our cultural understanding that corporations exist for the benefit of their shareholders. Second, to the extent that legal reforms strengthen shareholder power, this further locks in the corporate governance machine's orientation. Consider, for example, Dodd-Frank's say-on-pay mandate.[308] This rule gave shareholders a non-binding vote on executive compensation, and in so doing also amplified the role of proxy advisors who supply voting advice to meet investor interests and consult corporations in structuring pay-for-performance compensation.[309] Therefore, in addition to making management subject to shareholder voice in this area, the rule further sustains players who perpetuate the dynamics of the corporate governance machine.

B. Dictating One-Size-Fits-All Governance

The operation of the corporate governance machine may have negative consequences for shareholders, too. Despite any consensus about universal good governance practices, the corporate governance machine pushes many firms toward one-size-fits-all governance solutions. These solutions are often embodied in corporate governance codes adopted by industry groups, as well as the voting guidelines adopted by proxy advisors and major institutional investors.

According to these codes and guidelines, company governance should be modeled after a set of best practices. These best practices emphasize board independence, equal shareholder voting rights, tying executive compensation to performance, and governance structures that enhance responsiveness to shareholders. And companies that do not fall in line with these principles suffer consequences. For example, ISS recommends a no-vote for any company that has a staggered

---

[304] *See* Attracta Mooney & Billy Nauman, *Larry Fink Rules on the Best Global Standards for Climate Risk Reporting*, FIN. TIMES (Jan. 19, 2020), https://www.ft.com/content/fc51227b-9d64-4e5a-b1e2-f6c07f4caa58.

[305] Hall & Huber, *supra* note 283.

[306] Global trends toward investor stewardship and ESG disclosure requirements might also encourage U.S. investors to integrate ESG measures. *See* Renaud Breyer & Laurent Capolaghi, *Key Impacts of the New ESG Disclosure Rules for the Fund Ecosystem*, EY (Jan. 16, 2020), https://www.ey.com/en_lu/wealth-asset-management/luxembourg-market-pulse/esg---stewardship---key-impacts-of-the-new-esg-disclosure-rules- (discussing ESG transparency requirements on European fund managers); UK Stewardship Code 2020, https://www.frc.org.uk/investors/uk-stewardship-code (establishing twelve stewardship principles for U.K. asset managers and asset owners).

[307] To the extent that shareholder value diverges from social welfare, the regulatory trend we discuss presents troubling consequences. *See* Berger, *supra* note 143, at 666–67 (arguing that "a stockholder primacy ideology means that corporate purpose generally will be decided by what is in the interests of the top 10 percent income bracket in this country"); Bratton, *supra* note 40, at 788 ("[S]hareholder value does not proxy for social welfare and no progress in that direction has registered during the shareholder value era.").

[308] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 951, 124 Stat. 1376, 1899 (2010).

[309] Randall S. Thomas, Alan R. Palmiter & James F. Cotter, *Dodd-Frank's Say on Pay: Will It Lead To a Greater Role for Shareholders in Corporate Governance?*, 97 CORNELL L. REV. 1213 (2012).

board.[310] Influential institutional investors further enforce these precepts through their voting practices.[311] As a result, the governance structure of most large U.S. public companies looks nearly the same: annual director elections, majority voting, proxy access, no poison pill, and independent board leadership.[312]

The difficulty, of course, is that there is little evidence that maximum accountability to shareholders is the right choice for every company—even from the perspective of shareholder wealth maximization.[313] Indeed, there is evidence that one-size governance solutions can destroy value.[314]

Consider a technology company that is pursuing "moonshot" innovation that has never been done before and might require long periods of gestation. That company might benefit from greater insulation from investor pressure—a staggered board, and perhaps even a dual-class structure, in order to pursue its vision and secure the best long-term results.[315] Or consider a mature biotechnology company with complex products and highly technical operations. That company faces substantial tradeoffs when it brings an independent director on board; on the one hand, that director may be less beholden to management, on the other, she may be less likely to understand the company's operations. Indeed, the optimal board of directors for this company from the perspective of shareholders might feature very few, if any, independent directors. However, the

---

[310] James Cheap, *Board Classification and Diversity in Recent IPOs*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Apr. 24, 2018), https://corpgov.law.harvard.edu/2018/04/24/board-classification-and-diversity-in-recent-ipos/ (citing ISS PROXY VOTING GUIDELINES , *supr*a note 267, at 17).

[311] Colin J. Diamond et al., White & Case, *BlackRock Publishes Updated Proxy Voting Guidelines* (Feb. 21, 2018), https://www.whitecase.com/publications/alert/blackrock-publishes-updated-proxy-voting-guidelines.

[312] KOSMAS PAPADOPOULOS ET AL., ISS, U.S. BOARD STUDY: BOARD ACCOUNTABILITY PRACTICES REVIEW (Apr. 17, 2018), https://www.issgovernance.com/file/publications/board-accountability-practices-review-2018.pdf. Note that this effect is most pronounced for the largest U.S. companies. *See* Kosmos Papadopolous et al., *U.S. Board Study: Board Accountability Practices Review*, ISS (2008), https://www.issgovernance.com/file/publications/board-accountability-practices-review-2018.pdf ("Governance practices between S&P 500 and the rest of the members of the S&P 1500 continue to differ significantly. More importantly, the rate of governance change between the two groups varies in many areas, as large-caps tend to adopt shareholder-friendly board accountability practices more quickly compared to smaller firms.").

[313] *See, e.g.*, Zohar Goshen & Doron Levit, *Irrelevance of Governance Structure* (Colum. L. & Econ., Working Paper No. 603, 2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3340912 ("[A]lmost every aspect of corporate governance that was studied in the last forty years yielded conflicting empirical findings, for instance: dual-class shares; anti-takeover defenses, such as poison pills, staggered boards, and protective state legislations; and the strength of corporate governance as measured by several indices.").

[314] For example, there is evidence that mandatory board independence requirements can harm firm value when applied to different companies. *See* Jeffrey L. Coles, Naveen D. Daniel & Lalitha Naveen, *Boards: Does One Size Fit All?*, 87 J. FIN. ECON. 329 (2008); Onur Tosun, *Changes in Corporate Governance: Externally Dictated vs Organically Determined* (WBS Fin., Research Paper No. 246, 2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3105695. Likewise, the stock market negatively reacts to companies that change their executive compensation practices before a shareholder vote because of proxy advisor recommendations—indicating that such proxy advisor recommendations (which tend to follow a one-size-fits-all rubric) do not create shareholder value. *See* Larcker et al., *supra* note 175, at 173–204. Companies that separate the chairperson and CEO roles in response to shareholder pressure likewise experience a lower valuation and reduced operating performance. *See* Aiyesha Dey, Ellen Engel & Xiaohui Liu, *CEO and Board Chair Roles: To Split or Not to Split?*, 17 J. CORP. FIN. 1595 (2011). Finally, researchers in the UK have determined that companies that depart from default corporate governance code provisions tend to have better performance than those that comply with pre-set defaults. Sridhar Arcot & Valentina Bruno, *One Size Does Not Fit After All: Evidence From Corporate Governance*, 4 J. EMPIRICAL LEGAL STUD. 1041 (2007)..

[315] *See* Zohar Goshen & Assaf Hamdani, *Corporate Control and Idiosyncratic Vision*, 125 YALE L.J. 560 (2016).

corporate governance machine will push the company toward less-qualified yet independent directors, undermining the company's optimal governance.

Ultimately, this issue deserves additional study; here, we observe that, to the extent that the operation of the corporate governance machine dictates a governance blueprint for vastly different firms, it may erode corporate value. Paradoxically, it also undermines the unfettered bargaining model that underpins shareholder primacy.[316] A key premise in the law and economics defense of shareholder primacy is that a corporation is a nexus of contracts, and that parties can freely contract for rules that are welfare-maximizing.[317] But the path dependence that arises from dogmatically equating certain shareholderist practices with good governance, and the influence of market players that profit from establishing and maintaining this playbook, may restrict the range of options that firms adopt. Over time, this dynamic may limit the enabling nature of corporate law that many scholars champion as welfare-maximizing.

C. Hampering Corporate Governance Innovation

The corporate governance machine's emphasis on a platonic governance ideal leads to an additional and closely related result: it hampers innovation in corporate governance. In other words, the corporate governance machine not only forces corporations to adopt the same governance blueprint, it also restricts the items that appear on the menu.

Corporate governance innovation has become relatively rare.[318] Indeed, apart from the benefit corporation, one of the last major innovations—the poison pill—was a brainchild of the 1980s designed to respond to the increased risk of a hostile takeover.[319] As the rest of this Section explains, the accompanying crackdown in its use was itself a product of the nascent corporate governance machine. And it provides an example of the lifecycle of innovations in corporate governance that do not fit cleanly within the shareholder primacy framework.

The first poison pill was used in the early 1980s, at the advent of the hostile takeover wave.[320] Its rise in popularity kicked off a legal battle as to whether it was a proper exercise of board discretion. To convince the Delaware Supreme Court of its propriety, the pro-management lawyers who developed the pill went to great lengths to suggest that its use would benefit shareholders, dubbing it a "shareholder rights plan," and arguing that its use was necessary to secure a fair offer for the company's shares.[321] The Delaware Supreme Court validated the pill, and companies continued to adopt them into their charters.[322] The popularity of the pill, however, sparked a wave of pushback. Many academics, lawyers, proxy advisors, and investors decried the use of a tool that

---

[316] *See* BAINBRIDGE, *supra* note 260, at 33 (discussing how the shareholder wealth maximization norm is a "bargained-for contract term" in the contractarian model and rests "on the presumption of validity a free market society accords voluntary contracts").

[317] *See* EASTERBROOK & FISCHEL, *supra* note 8, at 66–72.

[318] Robert B. Thompson, *Why New Corporate Law Arises: Implications for the 21st Century*, *in* THE CORPORATE CONTRACT IN CHANGING TIMES: IS THE LAW KEEPING UP? (Steven Davidoff Solomon & Randall Stuart Thomas eds., 2019).

[319] Chase deKay Wilson, *Marty Lipton's Poison Pill*, 3 INT'L FIN. L. REV. 10 (1984).

[320] D.L. Sunder, *The Controversial 'Poison Pill' Takeover Defense: How Valid Are the Arguments in Support of It?*, 23 NMIMS MGMT. REV. 47 (2013).

[321] *See* Answering Br. of Defs., *Moran v. Household Int'l*, No. 37, 1985, https://www.law.upenn.edu/live/files/7383-a.

[322] *See* Moran v. Household Int'l, 500 A.2d 1346 (Del. 1985); Gerald F. Davis, *Agents Without Principles? The Spread of the Poison Pill Through the Intercorporate Network*, 36 ADMIN. SCI. Q. 583, 585 (1991) (noting that by 1989, 60% of the Fortune 500 had poison pills).

they deemed entrenching.[323] That was so despite the fact that the empirical evidence about whether the poison pill benefitted shareholders was mixed.[324] However, after being labeled a tool of "bad governance," the corporate governance machine has all but eliminated the use of poison pills at public companies as a matter of standing governance.[325] Even Wachtell Lipton, the law firm credited with the pill's invention, noted in response to the Covid-19 pandemic and the corresponding resurgence in pills that "the negative view of rights plans by the proxy advisory services and some institutional investors" makes it generally inadvisable for companies to adopt a poison pill without a specific threat.[326]

For another example of the issues that accompany governance innovation, consider the blowback against the use of dual-class stock. For the past hundred years, dual-class stock has been used to respond to different business concerns. For example, in the 1920s, bankers used differential voting rights as a way of keeping control over the companies they took public. Their argument was that the use of differential voting rights helped control agency costs and signal managerial quality in an era with few disclosure requirements and weak investor protections.[327] Dual-class stock has since been used as a takeover defense, to keep control with families in family-owned companies, to protect the journalistic integrity of media companies, and most recently, to keep control with visionary technology company founders taking their companies public.[328] And despite these varied uses, the form of criticism that has followed each iteration has been the same—that dual-class structures are anti-democratic and lead to entrenchment and thus should be discouraged or even prohibited.[329]

The pushback against the most recent wave of dual-class IPOs by technology companies provides an example of this dynamic in action. As companies began offering low-voting and non-voting stock to public shareholders—again, with the stated goal of benefitting shareholders in the long term—the corporate governance machine began to work. In particular, proxy advisors, investor advocacy groups, and prominent investors saw the use of non-voting stock as an entrenching governance practice and began speaking out against it.[330] These groups lobbied stock exchanges, stock indices, and the SEC, seeking regulation limiting a company's ability to issue differential shares. The media also painted dual-class structures and non-voting shares in a negative light.[331] Despite protestations by scholars and companies that differential voting rights would

---

323 *See, e.g.*, Ronald J. Gilson, Unocal *Fifteen Years Later (and What We Can Do About It)*, 26 DEL. J. CORP. L. 491 (2001); Sunder, *supra* note 320.

324 *See, e.g.*, John C. Coates, *Takeover Defenses in the Shadow of the Pill: A Critique of the Scientific Evidence*, 79 TEX. L. REV. 271 (2000).

325 They typically exist only as a "shadow" option. *Id.*

326 David Katz & Sabastian V. Niles, Wachtell, Lipton, Rosen & Katz, *Rights Plans ("Poison Pills") in the COVID-19 Environment—"On the Shelf and Ready to Go"?*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Apr. 2, 2020), https://corpgov.law.harvard.edu/2020/04/02/rights-plans-poison-pills-in-the-covid-19-environment-on-the-shelf-and-ready-to-go/.

327 *See* Jeffrey N. Gordon, *Dual Class Common Stock: An Issue of Public and Private Law*, CLS BLUE SKY BLOG (Jan. 2, 2019), https://clsbluesky.law.columbia.edu/2019/01/02/dual-class-common-stock-an-issue-of-public-and-private-law/; *see also* John C. Coffee, Jr., *Dual Class Stock: The Shades of Sunset*, CLS BLUE SKY BLOG (Nov. 19, 2018), https://clsbluesky.law.columbia.edu/2018/11/19/dual-class-stock-the-shades-of-sunset/.

328 *See supra* note 202 and accompanying discussion.

329 *See* Lund, *Nonvoting Shares*, *supra* note 200.

330 INSTITUTIONAL S'HOLDER SERVS., THE TRAGEDY OF THE DUAL CLASS COMMONS 3 (Feb. 3, 2012)), https://perma.cc/FQ4E-PLPE.

331 *See, e.g.*, Kathleen Pender, *Lyft Wants the Public's Money, But Not Their Input*, S.F. CHRON. (Mar. 20, 2019, 7:29 AM), https://www.sfchronicle.com/business/networth/article/Lyft-wants-the-public-s-money-but-not-their-

sometimes benefit shareholders, three major stock index providers, including MSCI, FTSE Russell, and S&P Dow Jones, proposed to exclude prospective dual-class companies from their indices.[332]

Although agency theory adherents might celebrate this result as a win for promoting shareholder democracy and minimizing managerial agency costs, a less rosy view is that the corporate governance machine constrains value-enhancing experimentation in governance when that innovation threatens shareholder rights.[333] And as before, this orientation undermines the enabling nature of corporate law that is often described as its most desirable feature.[334]

D. Influencing the Public/Private Divide

A greater diversity of governance arrangements emerges in the private company context, yet this observation also tells us something about the corporate governance machine. Private companies regularly depart from the corporate governance machine's precepts: many private companies have unequal voting rights, founder-dominated boards, and other "bad governance" characteristics.[335] These governance arrangements have been accepted as tolerable, or even necessary, to protect small, innovative companies with visionary founders or companies that wish to stay true to social mission.[336]

This all changes once a company goes public: newly minted public companies are subject to heightened scrutiny from institutional investors, ratings agencies, investor advocacy groups, stock exchanges, stock indices, and proxy advisors. As a result, most private companies are forced to shed the governance practices that shaped their early growth as soon as they access the public markets.[337] They must conform their boards to public company rules and norms regarding size and composition, such as those favoring director independence.[338] They must also deal with the reality

---

13701367.php; Kara Swisher, *You Can't Fire Mark Zuckerberg's Kid's Kids*, N.Y. TIMES (Nov. 27, 2019), https://www.nytimes.com/2019/11/27/opinion/tech-dual-class-stock.html.

[332] *Id.* at 692. MSCI has since changed course.

[333] An optimal governance structure might, for example, take into account principal costs as well as agency costs. *See* Zohar Goshen & Richard Squire, *Principal Costs: A New Theory for Corporate Law and Governance*, 117 COLUM. L. REV. 767 (2017).

[334] *See generally* ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW (1993).

[335] *See generally* Elizabeth Pollman, *Startup Governance*, 168 U. PA. L. REV. 155 (2019) (describing venture capital contracting and the governance of venture-backed startups); *see also* Renee M. Jones, *The Unicorn Governance Trap*, 166 U. PA. L. REV. ONLINE 169 (2017) (arguing unicorn companies present "governance problems"); Josh Lerner & Ramana Nanda, *Venture Capital's Role in Financing Innovation: What We Know and How Much We Still Need to Learn* 12–13 (NBER, Working Paper No. w27492, 2020), https://www.nber.org/papers/w27492 (arguing "founder-friendly" structures reflect "declining governance" of startups).

[336] *See* Pollman, *supra* note 335, at 181–83, 205 (discussing the dynamics in which startup founders bargain for dual-class structures or other protections); Goshen & Hamdani, *supra* note 315, at 577–79 (discussing idiosyncratic vision); YVON CHOUINARD, LET MY PEOPLE GO SURFING: EDUCATION OF A RELUCTANT BUSINESSMAN 155 (Penguin Books 2005) ("Being a publicly held corporation . . . would put shackles on how we operate, restrict what we do with our profits, and put us on a growth/suicide track. Our intent is to remain a closely held private company, so we can continue to focus on our bottom line: doing good.").

[337] Pollman, *supra* note 335, at 209–10 ("Going public offers a chance to unwind a complicated and largely contractual governance structure in favor of a more traditional allocation of rights and responsibilities."); *see also* SCOTT KUPOR, SECRETS OF SAND HILL ROAD 160–61 (2019) (discussing how preferred stock converts to common stock at IPO).

[338] *See, e.g.*, David F. Larcker & Brian Tayan, *Scaling Up: The Implementation of Corporate Governance in Pre-IPO Companies* (Stan. Closer Look Series, 2018), https://www.gsb.stanford.edu/faculty-research/publications/scaling-implementation-corporate-governance-pre-ipo-companies (discussing IPO "readiness" through evolution of corporate governance practices in private companies).

that they will be subject to the demands of a host of new shareholders that are well-positioned to use their governance rights to ensure alignment with shareholder interests.[339] Companies like Google and Facebook that maintain private-style governance in their voting structures are in the minority, and even these companies face intense public scrutiny and pressures to conform their practices.

The insight that the corporate governance machine contributes to this result is an important missing piece of the discussion about why companies are choosing to stay private longer. Previous scholarship has focused on the availability of private capital, burdensome regulation and disclosure requirements, the increased prospect of agency costs that comes from a dispersed shareholder base, and increased litigation.[340] However, the corporate governance machine serves as another powerful deterrent for companies that might otherwise access public markets sooner in their life cycle—and one that is even more difficult to grapple with. Startups with visionary leaders and market leverage have pushed for dual or multi-class structures to insulate themselves from the corporate governance machine—and in so doing have been one of the few sources of governance variation injected into public markets.

The corporate governance machine may also affect the balance of whether certain activities are performed by large public companies, rather than smaller private ones. For example, there is evidence that the corporate governance machine's emphasis on shareholder value and accountability to shareholders render public companies less likely to invest in research and development relative to private companies.[341] Investments in research and development do not always pan out and shareholders may prefer that excess cash be returned to them rather than spent on speculative projects. Public companies might embrace this cost-saving strategy despite the potential for investments in research and development to fuel growth and innovation that produce long-term social benefits and strengthen sustainability in competitive global market economies. In any case, the corporate governance machine's influence should be viewed as contributing not only to the trend of companies staying private longer and pushing for dual-class structures, but also shaping the activity of those in the public realm.

E. The Future of Corporate Governance

We have thus far examined a range of implications that arise from a shareholderist-oriented corporate governance machine. In this final part of our discussion, we reflect on the future direction of the U.S. system of corporate governance.

A central implication from our analysis is that advocates of corporate social responsibility or stakeholderism that wish to see a move away from shareholder primacy will be frustrated by the

---

[339] *See* Claudine Gartenberg & George Serafeim, *181 Top CEOs Have Realized Companies Need a Purpose Beyond Profit*, HARV. BUS. REV. (Aug. 20, 2019), https://hbr.org/2019/08/181-top-ceos-have-realized-companies-need-a-purpose-beyond-profit (finding "lower levels of purpose [other than shareholder wealth maximization] in publicly listed companies, relative to private firms").

[340] *See* Elisabeth de Fontenay, *The Deregulation of Private Capital and the Decline of the Public Company*, 68 HASTINGS L.J. 445, 462 (2017) (discussing literature on the costs of public company status).

[341] *See* Josh Lerner et al., *Private Equity and Long-Run Investment: The Case of Innovation*, 66 J. FIN. 445 (2011) (documenting that firms register more quality patents after going private); John Asker et al., *Corporate Investment and Stock Market Listing: A Puzzle?*, 28 REV. FIN. STDS. 342 (2015) (finding that public firms invest less than a matched sample of private firms).

corporate governance machine. The diversity of corporate governance systems around the world, and the failure of the convergence hypothesis to materialize, demonstrates that a shareholder-dominated system is not inevitable.[342] Yet it has proven sticky in the United States and, as it has permeated law, markets, and culture, it has generated a reinforcing momentum. And ultimately, this means that anything short of a major federal intervention is unlikely to result in dramatic changes in corporate decisionmaking.

To understand why more incremental change is unlikely to manifest substantial gains for stakeholders, consider the following hypothetical scenario: Imagine that the Delaware Supreme Court stated in a judicial opinion that corporate fiduciaries could choose to sacrifice shareholder returns (over the long and short term) to benefit employees or the public at large.[343] Such a statement would end the doctrinal debate over corporate purpose that has consumed much scholarly attention for the past few decades. But with what effect? Will Amazon award a larger share of profits to its warehouse workers? Will American Airlines make costly upgrades to its equipment to reduce the company's carbon emissions? Will ExxonMobil stop exploring for oil and gas?

Additional legal discretion will not likely result in these operational changes. And the corporate governance machine is largely to blame. Routine profit-sacrificing is unlikely to increase the company's stock price, and therefore, these actions could lead to a cascade of negative consequences for the management team. Most directly, the decision to put other groups ahead of shareholders could sacrifice management's own compensation, which has become increasingly tied to the company's financial performance as a result of pressure from the machine's market players. Perhaps even more importantly, the decision might attract negative attention from investors, especially if governance ratings agencies downgraded the company in the wake of the move.[344] Other shareholders might instead use their governance rights to show disapproval such as by voting against executive pay at the next annual meeting. Proxy advisors, too, would likely react unfavorably, directing their shareholder clients to vote against management. Investor advocacy groups would similarly protest any move that downgraded shareholder value. And if the company continued to make significant prosocial profit-sacrificing choices into the future, it is likely that influential investors with concentrated investments in the company would do more, or activists would take positions to do so. For example, those investors could wage a proxy fight until management changed course or was replaced with individuals who were better aligned with shareholder interests.[345]

Put simply, legal discretion is not enough to change corporate behavior if the other components of the corporate governance machine remain intact. To regularly sacrifice profits to benefit the public, a company's management would need insulation from shareholders, but this insulation is anathema to the corporate governance machine.[346] Not only that, pay-for-performance

[342] For a sampling of the literature examining corporate governance divergence, see Gelter, *supra* note 80; Rafael La Porta, Florencio López-de-Silanes & Andrei Shleifer, *Corporate Ownership Around the World*, 54 J. FIN. 471 (1999); ROE, *supra* note 240.

[343] In some respects, this hypothetical is not far from existing doctrine as many scholars would already characterize corporate law as director-centric in terms of the balance of managerial power and discretion afforded to boards of directors. *See* Bainbridge, *Director Primacy*, *supra* note 4; Blair & Stout, *supra* note 85.

[344] *See supra* Section II.B.3–4.

[345] *See* Hart & Zingales, *supra* note 13.

[346] *See supra* notes 69–79 and accompanying text.

compensation that has become a tenet of good governance further disincentivizes decisions to shift value away from shareholders and toward other groups. What about culture? Although shareholder primacy has recently come under pressure in our cultural understanding of how companies should operate, at the end of the day, "good governance" continues to be defined by its link to accountability to shareholders.[347] It is not clear that the growing cultural acceptance of an enlightened approach toward stakeholders will put out the shareholder primacy fire that fuels the corporate governance machine, although it may impact its evolution.

The key point is that as the shareholder primacy viewpoint has become enmeshed in our cultural and institutional understanding of good governance, and as multiple powerful players operate as gatekeepers for the shareholder primacy norm, it becomes difficult to move to another paradigm—one that gives power to other stakeholders or allows corporate executives to make decisions based on the corporate entity, overall social value, or something else. And without a substantial shock to the system, such as a federal chartering requirement directing companies to adopt a stakeholder governance model,[348] stakeholderism is unlikely to dethrone shareholder primacy as the dominant decisionmaking framework.

Instead, stakeholderism will continue to shape the practice of shareholder primacy. There is already increased recognition that consideration of stakeholder welfare is necessary for corporate profit maximization over the long term. As shifts in understanding occur regarding the merits of various ESG initiatives, and better metrics develop for measuring these benefits, a greater level of stakeholder interests can be reconciled with pursuing long-term shareholder value. Not only that, some observers have urged corporations to consider shareholder value more holistically, recognizing that shareholders are individuals with diverse preferences. And because these "enlightened" shareholder primacy perspectives incorporate stakeholder interests into shareholderism, they are likely to make it through the corporate governance machine.

But although an enlightened shareholder value approach allows for greater consideration of stakeholder welfare, it ultimately serves only a partial victory to advocates of stakeholderism. In particular, tying the consideration of stakeholder welfare to long-term shareholder value limits acceptable rationales and favors activity that can be reduced to measurable metrics tied to risk or financial value. It also renders the promotion of stakeholder welfare that cannot be justified as benefitting shareholders as outside the bounds of acceptable corporate activity, no matter the overall welfare benefits.

The acceptance of an enlightened shareholder value approach also means that the corporation's social conscience will be externally determined. Take sexual harassment as an example. The success of the #metoo movement has created a business case for sexual harassment prevention,[349] but before 2017, such socially desirable corporate activity was often neglected as it did not pose a meaningful risk to shareholder value. Without this external pressure, there was no impetus for change, regardless of the social benefits. Simply put, tying a company's obligation to engage in

[347] *See supra* notes 75–79, 206–210 and accompanying text.
[348] *See, e.g.*, Accountable Capitalism Act, *supra* note 2. This proposed legislation could throw sand in the gears of the machine by mandating sweeping corporate governance changes including requiring employee representatives to serve on the board, requiring federal charters for large corporations, and giving directors the duty to create a general public benefit. *Id.*
[349] *See* Dorothy Lund, Public Primacy in Corporate Law (unpublished manuscript) (on file with authors); Daniel Hemel & Dorothy Lund, *Sexual Harassment and Corporate Law*, 118 COLUM. L. REV. 1583, 1622 (2018).

socially beneficial conduct to value maximization means that much desirable conduct will slip through the cracks.

Not only that, we predict that the corporate governance machine will affect the future path of corporate ESG. As discussed, surviving the corporate governance machine requires the embrace of its market players. And as we have begun to see, ESG can create business opportunities for many of them, and proxy advisors, stock exchanges, and ratings agencies in particular. As such, these market players are likely to embrace ESG activities that can be easily measured and scored, for investor and perhaps even public consumption. This in turn will shape the types of ESG activities that companies choose to engage in. And over time, as market players continue to develop metrics and products for companies at scale, we predict that corporate ESG activities will tend to take a one-size-fits-all form, too.

As one example of this progression, consider board diversity. In the past few years, a number of market participants have made gender diversity a priority; in particular, the influential investor State Street promised to vote against nominating directors of companies that lacked any female directors in 2017.[350] This initiative led a number of companies to add female directors;[351] however, racial and ethnic diversity remained neglected. More recently, other market players, and the influential stock exchange NASDAQ in particular, have adopted requirements mandating that listed companies have a diverse director that self-identifies as an underrepresented minority or LGBTQ+.[352] Although we applaud these efforts, we note again that the result for many companies will likely be compliance in a check-the-box fashion, with companies electing the minimum number of diverse directors without necessarily taking a critical look at whether their boards (and the rest of their workforce) are truly representative.

In sum, the legacy of the corporate governance machine is not just the continued constraint of corporate activity in the service of shareholder welfare, but also the co-optation of stakeholderism. The desirability of this reality is subject to much debate, but as our analysis indicates, wholesale change away from this model is unlikely to manifest absent a substantial shock to the system.

CONCLUSION

Understanding the complex and reinforcing nature of the U.S. corporate governance system is essential for understanding corporate decisionmaking and how to reform it. Our descriptive account of the corporate governance machine has wide-ranging implications for multiple conversations in corporate law, and the debate over corporate purpose in particular. Indeed, as the cultural conversation has turned to increasingly vocal calls for reorientation of purpose away from shareholder primacy, our Article sheds light on the complexity of this project. As shareholder primacy has evolved from a rule to a system, it has generated a reinforcing momentum. As such,

---

[350] Joann S. Lublin & Sarah Krouse, *State Street to Start Voting Against Companies That Don't Have Women Directors*, WALL ST. J. (Mar. 7, 2017), https://www.wsj.com/articles/state-street-says-it-will-start-voting-against-companies-that-dont-have-women-directors-1488862863?mod=article_inline.

[351] Amy Whyte, *State Street to Turn Up the Heat on All-Male Boards*, INST. INV. (Sept. 27, 2018), https://www.institutionalinvestor.com/article/b1b4fh28ys3mr9/State-Street-to-Turn-Up-the-Heat-on-All-Male-Boards.

[352] Press Release, Nasdaq, Nasdaq to Advance Diversity Through New Proposed Listing Requirements (Dec. 1, 2020), https://www.nasdaq.com/press-release/nasdaq-to-advance-diversity-through-new-proposed-listing-requirements-2020-12-01.

stakeholderism may gain ground by shaping the meaning of shareholder primacy to construe shareholder value more broadly. Indeed, this may well be the legacy of the corporate governance machine over the long-term: even when traditional the shareholder primacy viewpoint no longer wins the day, the apparatus that it generated will influence corporate conduct and the path of legal reform for years to come.

about ECGI

The European Corporate Governance Institute has been established to improve *corporate governance through fostering independent scientific research and related activities.*

The ECGI will produce and disseminate high quality research while remaining close to the concerns and interests of corporate, financial and public policy makers. It will draw on the expertise of scholars from numerous countries and bring together a critical mass of expertise and interest to bear on this important subject.

The views expressed in this working paper are those of the authors, not those of the ECGI or its members.

Electronic Access to the Working Paper Series

The full set of ECGI working papers can be accessed through the Institute's Web-site (https://ecgi.global/content/working-papers) or SSRN:

Finance Paper Series	http://www.ssrn.com/link/ECGI-Fin.html
Law Paper Series	http://www.ssrn.com/link/ECGI-Law.html