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# The Law of Corporate Purpose

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# The Law of Corporate Purpose

David G. Yosifon[1]

*Delaware corporate law requires corporate directors to manage firms for the benefit of shareholders, and not for any other constituency. Delaware jurists have been clear about this in their case law, and they are not coy about it in extra-judicial settings, such as speeches directed at law students and practicing members of the corporate bar. Nevertheless, the reader of leading corporate law scholarship is continually exposed to the scholarly assertion that the law is ambiguous or ambivalent on this point, or even that case law affirmatively empowers directors to pursue non-shareholder interests. It is shocking, and troubling, for corporate law scholarship to evince such confusion about the most important black letter matter in the field. While I am a critic of the "shareholder primacy norm" in corporate governance, I am nevertheless convinced that shareholder primacy is the law. In fact, the critical vantage and reformative program that I have pursued in other writing presupposes that shareholder primacy is currently the law. This Article is therefore dedicated both to providing doctrinal clarification on the law of corporate purpose and to vindicating a key presumption in a broader normative agenda.*

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# The Law of Corporate Purpose

*"[T]he shareholder wealth maximization norm . . . indisputably is the law in the United States."*[2]
-Stephen M. Bainbridge

*"The notion that corporate law requires directors . . . to maximize shareholder wealth simply isn't true."*[3]
-Lynn A. Stout

## I. INTRODUCTION

Corporate law scholars are divided on the fundamental question of what boards of directors are supposed to do with the corporations they command. It would be no shock to find disagreement on the normative question of what the law of corporate purpose should be. But corporate law scholars are at odds even on the positive question of what the law *is* on this most basic doctrinal issue. Many in the field take it as given that corporate boards are supposed to pursue profits for shareholders and that directors have neither the obligation nor the right to pursue other interests. This view seems also to be widely accepted in broader social and political discourse about corporate operations. Readers of corporate law scholarship, however, are continually confronted with the claim, made by some of the field's most accomplished academics, that the law allows directors to steer the corporate ship in service of non-shareholding stakeholders, including employees, consumers, and the public generally, even when shareholder interests are in tension with such pursuits.

This is more than *an* important issue. It is *the* most important issue in corporate law, and one of the most important questions in contemporary social organization. Scholars, policymakers, and the public at large are all rightly concerned with the question of what corporate law does or might do. Effective deliberation on this issue must be informed by a clear expression of what the law presently requires. The confusion in the literature on corporate purpose is therefore not just embarrassing, it is disempowering. In this Article, I endeavor to clarify what the law of corporate purpose is in order to help advance conver-

2. STEPHEN M. BAINBRIDGE, THE NEW CORPORATE GOVERNANCE IN THEORY AND PRACTICE 53 (2008).

3. LYNN STOUT, THE SHAREHOLDER VALUE MYTH: HOW PUTTING SHAREHOLDERS FIRST HARMS INVESTORS, CORPORATIONS, AND THE PUBLIC 29 (2012).

sations about what the law of corporate purpose ought to be.

Scholars who are convinced that the law requires shareholder primacy in firm governance tend to also insist that such a governance norm is desirable.[4] Scholars who claim that the law allows for a broader corporate agenda tend to argue that director attention to non-shareholder concerns is a good thing.[5] My own view is that shareholder primacy is indeed the law, but I advocate reforms that would impose broader responsibilities on corporate boards. I have developed my normative view in a series of articles.[6] However, I am concerned that confusion in the academy's positive assessment of corporate law detracts from what might otherwise be a more direct and unified call for reform of the prevailing regime. This Article, therefore, both demonstrates that the black letter law of corporate governance is shareholder primacy and explains the missteps that I believe other scholars have made in interpreting that doctrine.[7] I focus exclusively on Delaware law because Delaware dominates the corporate law landscape in the United States.[8]

The Article is organized as followed. Part II dives into statutory and case law and climbs out with a positive assessment that Delaware demands shareholder primacy in corporate governance. Part III looks beyond formal law and examines extra-juridical statements that Delaware jurists have made about their state's law. It shows that Delaware jurists have not been coy in expressing their view that Delaware law requires directors to advance shareholder interests and permits no other purpose in the boardroom. Part IV examines the academic confusion on this question. Part V concludes the Article with an examination of the normative stakes involved in settling this (I hope no longer) ongoing doctri-

4. Clarification about the phrase "shareholder primacy" is in order at the start. Corporate law scholars sometimes use the phrase "shareholder primacy" as a description of the *purpose* of corporate governance (i.e., that the purpose is to advance shareholder interests); other times the phrase "shareholder primacy" is used as a description of the *method* of corporate governance (i.e., a method that allows significant shareholder influence in the mechanics of governance). This phraseological ambiguity can be confusing and should be cleaned up. In this piece, I use the phrase "shareholder primacy" to refer to corporate purpose. It is too familiar and elegant a phrase to exclude from an article on this subject.

5. *See infra* Section IV (reviewing scholarship).

6. *See infra* Section V (summarizing this scholarship).

7. Scholars who believe that shareholder primacy is the law typically treat the proposition as self-evident and do not rigorously make the case for it in their scholarship. *See* STOUT, *supra* note 3, at 115 (collecting prominent examples of this). This Article therefore also serves to flesh out an important, but unproven, premise in such scholarship.

8. Sixty percent of publicly traded companies in the United States are incorporated in Delaware, and thus, by operation of the "internal affairs doctrine," are subject to Delaware's corporate governance law. *See* John Armour et. al., *Delaware's Balancing Act*, 87 IND. L. J. 1345, 1348 (2012). As of 2010, sixty-three percent of Fortune 500 companies were Delaware firms, and, in 2010, seventy-six percent of initial public offerings in the United States were Delaware firms. *Id.* at 1382.

nal dispute.

## II. *EX CATHEDRA*: DOCTRINE

### *A. The Statute: Delaware General Corporation Law*

Not formed by nature or common law, corporations are creatures of statute. To find the purpose of Delaware corporations, therefore, it would seem appropriate to start with the statute. Unfortunately, the statute provides no crisp declaration on this point. The code states that "a corporation may be incorporated or organized under this chapter to conduct or promote any lawful business or purposes."[9] The code commands that the articles of incorporation of every firm must "set forth . . . the nature of the business or purposes to be conducted or promoted."[10] However, this requirement can be satisfied if the articles state "either alone or with other business purposes, that the purpose of the corporation is to engage in any lawful act or activity for which corporations may be organized."[11] So while the code feints towards clarity by requiring a statement of purpose, it lands with obscurity by allowing the purpose to be stated generally as the intent to pursue "any lawful act." In fact, most business corporations use this "any lawful act" language in the purpose section of their articles of incorporation.[12]

Once a corporation is formed, the code requires that it be managed: "The business and affairs of every corporation organized under this chapter *shall be*

9. DEL. CODE ANN. tit. 8, § 101(b) (West 2013).

10. *Id*. § 102(a).

11. *Id*. § 102.

12. If there was real doubt outside of corporate law scholarship about what the law of corporate governance requires, then the widespread failure of corporate lawyers to specify the constituency whose interests are to be served by a newly organized firm would be evidence of systematic professional blunder. But this routine omission is not blunder, because the law of corporate purpose in Delaware cannot reasonably be doubted. It appears that lawyers use the "any lawful act" language in corporate charters in order to give directors the widest possible latitude in deciding how to go about advancing shareholder interests. That is, incorporators do not specify that the purpose of their corporation is "to run a railroad" because they know that directors might someday consider it profitable to get the firm into the semiconductor business. *Cf.* CHRISTOPHER M. FORRESTER & CELESTE S. FERBER, FIDUCIARY DUTIES AND OTHER RESPONSIBILITIES OF CORPORATE DIRECTORS AND OFFICERS 9 (5th ed. 2012) (a handbook produced by Morrison & Foerster, LLP, for use by its corporate clients, stating: "One of the most difficult tasks for a board . . . is to balance the competing interests of multiple constituents of a business. . . . The difficulty arises when decisions do not affect all parties equally. . . . [T]here is a clear legal answer to the question: a corporation's board and management owe a fiduciary duty as their primary obligation, above all others, to the stockholders, to maximize the value of the equity of the corporation.").

*managed* by or under the direction of a board of directors."[13] But how will the directors of corporations formed to undertake "any lawful act" know what they are supposed to do with the firms they must manage? In the absence of a specified *beneficiary* in the articles of incorporation, is there a default constituency on whose behalf the firm should be managed? Or are directors to undertake lawful acts in a random fashion, without intent to serve any particular interest? Or may they manage the firm with the purpose of serving beneficiaries of their own choosing?

Indirectly, the Delaware code makes clear that by default directors owe fiduciary duties to the corporation and its stockholders.[14] I say indirectly because the first and only mention of this obligation comes in a part of the statute specifying that corporations may, if they so desire, choose to *excuse* directors from liability for breaches of that obligation. It states: "the certificate of incorporation may also contain . . . a provision eliminating or limiting the personal liability of a director to the corporation or its stockholders for monetary damages for breach of fiduciary duty."[15] This section also forbids limiting personal liability "for any breach of the director's duty of loyalty to the corporation or its stockholders"[16] or "for acts or omissions not in good faith."[17] This permissive exculpatory provision, and the limitation on it, indicates that by default directors owe fiduciary obligations of care, loyalty, and good faith to the corporation and its stockholders.[18] This is the only language in the Delaware statute that addresses the fiduciary obligations of corporate directors.

Of course, to say that a person owes fiduciary obligations to another person can only start a meaningful conversation; it cannot conclude it. What *goal* is the

13. DEL. CODE ANN. tit. 8, § 141(a) (West 2011) (emphasis added).

14. *See* infra, Section IV.B, arguing that Delaware statutory language and case law referencing director's obligations to "the corporation and its shareholders" cannot plausibly be read as support for the view that the law permits directors to run firms in the interests of stakeholders other than shareholders.

15. DEL. CODE ANN. tit. 8, § 102(b)(7) (West 2011). Section 145 authorizes corporations to indemnify directors, or other agents of the corporation, against liability and costs from any civil, criminal, or administrative action brought against them in connection with their service to the corporation, but only "if the person acted in good faith and in a manner the person reasonably believed to be in or not opposed to the best interests of the corporation." *Id.* § 145(a). That section also allows the corporation to purchase insurance on behalf of a director or other agent to cover liability incurred by such a person, "whether or not the corporation would have the power to indemnify such person against such liability under this section." *Id.* § 145(g). Thus while firms cannot exculpate or indemnify directors against liability for loyalty or good faith violations, they can insure them against liability for such wrongdoing.

16. *Id.* § 102(b)(7).

17. *Id.*

18. Even if the articles of incorporation include an exculpatory provision, directors still owe the fiduciary obligation of care; they simply will be protected from having to pay damages in connection with any finding that they violated that obligation.

fiduciary to pursue on behalf of the corporation and its stockholders, carefully, loyally, and in good faith? The statute does not specify. We are not told whether it is profits, profits with a conscience, profits balanced against the interests of other parties, short-term profits, long-term profits, or something else. All we know from the statute is that directors owe the corporation and its stockholders fiduciary obligations. Fortunately, a rich body of case law extends this conversation.

### *B. Case law*

This inquiry is concerned with Delaware law, but no review of corporate purpose can be properly undertaken without at least a ceremonial first-pitch from that venerable old Michigan case, *Dodge v. Ford*.[19] In the first fifteen years of its existence, the Ford Motor Company was wildly successful and paid tens of millions of dollars in dividends to its shareholders. In 1916, however, Henry Ford, the majority stockholder, chairman, and dominant personage at the company, announced that the firm would no longer pay discretionary dividends. Instead, profits would be reinvested in the company for the avowed purpose of increasing wages for workers and decreasing prices for consumers. "My ambition," Ford declared, "is to employ still more men, to spread the benefits of this industrial system to the greatest possible number, to help them build up their lives and their homes."[20] The Dodge brothers, minority shareholders in the company, sued Ford for violating his fiduciary obligations to them. The Michigan Supreme Court famously admonished Ford:

> There should be no confusion (of which there is evidence) of the duties which Mr. Ford conceives that he and the stockholders owe to the general public and the duties which in law he and his codirectors owe to protesting, minority shareholders. A business corporation is organized and carried on primarily for the profit of the shareholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that

19. 170 N.W. 668 (Mich. 1919); *but see* Lynn A. Stout, *Why We Should Stop Teaching* Dodge v. Ford, 3 VA. L. & BUS. REV. 163 (2008). I address Stout's arguments *infra* Section IV(A). As will also be seen, *infra* notes 52-59 and accompanying text, it is clear that Delaware jurists are at least inspired by *Dodge*.

20. Dodge, 170 N.W. at 683.

> end, and does not extend to a change in the end itself, to the reduction of profits, or the non-distribution of profits among stockholders in order to devote them to other purposes.[21]

Remarkably, the Michigan court cited no statute or case law for this decisive statement of its corporate governance law. It is as if the court considered it obvious.

The quote I have just reported is familiar to just about anyone who has sat through a survey course in corporate law. The lines have been cited in our secondary literature more than eight hundred times.[22] However, *Dodge* has been cited only 68 times by subsequent state and federal courts. It has been cited just three times, and never for the crucial issue of corporate purpose, in Delaware cases.[23] It is a decision about Michigan corporate law, and Michigan corporate law is not even very important in Michigan. Ford Motor Company itself is today a Delaware corporation.[24] (Having apparently learned from its ancestral missteps, the homepage of Ford's Board of Directors contains an unambiguous caption: "The members of our Board of Directors are dedicated to serving the interests of our shareholders."[25]) *Dodge* remains a useful case for teaching and scholarship because of its interesting facts and elegant language. It does accurately express the rule that binds Delaware directors. But it is not a great doctrinal citation for Delaware law.

Ceremony aside, then, let us turn to the most important Delaware cases on this issue. Delaware's jurisprudence on corporate purpose was most pointedly developed in a series of hostile takeover cases from the 1980s.[26] The first of

21. *Id.* The Court acknowledged that it is not forbidden for a corporation to engage in humanitarian undertakings that are incidental to its business. However, "the difference between an incidental humanitarian expenditure of corporate funds for the benefit of the employees, like the building of a hospital for their use and the employment of agencies for the betterment of their condition, and a general purpose and plan to benefit mankind at the expense of others, is obvious." *Id.*

22. *See* Westlaw citing references for Dodge, http://www.westlaw.com (search for *Dodge*, then click on "citing references") (as of January 1, 2013).

23. *See* Blackwell v. Nixon, No. 0941, 1991 WL 194725 (Del. Ch. Sept. 26, 1991); Hall v. John S. Isaacs & Sons Farms, 163 A.2d 288 (Del. 1960); E.I. Du Pont de Nemours & Co. v. Clark, 88 A.2d 436 (Del. 1952).

24. *See* Ford Motor Co., *Important Notice Regarding the Availability of Proxy Materials for the Shareholder Meeting*, 73 (Mar. 30, 2012), http://corporate.ford.com/doc/2012_proxy.pdf.

25. *See Members of Board of Directors*, FORD MOTOR CO., http://corporate.ford.com/our-company/our-company-news/our-company-news-detail/board-of-directors-801p (last visited June 6, 2012).

26. A hostile takeover involves an effort by one corporation (or entity, or person) to gain control of a "target" corporation against the wishes of the target's incumbent board of directors. Hostile takeovers present myriad legal questions. The most important issue in the cases discussed in the text here is whether and to what extent an incumbent board may use corporate powers to resist a hostile threat that

these, and the most mischievous for what it (has been read to have) said about corporate purpose, was *Unocal v. Mesa*[27] in 1985. T. Boone Pickens, through his Mesa firm, had announced a "structurally coercive" tender offer for 51 percent of Unocal, Inc., an underperforming oil concern.[28] The Mesa tender offer would have provided Unocal shareholders with a premium over the prevailing market price for their stock. However, Unocal's board believed that Mesa's offer was inadequate, in light of the board's beliefs about the long-term prospects of the company. The Delaware Supreme Court was called on to decide whether it was permissible for Unocal's board to deploy aggressive, costly measures to stymie Mesa's takeover bid. The Court concluded that defensive measures adopted by a board in response to an unwelcome takeover effort would be analyzed under a standard that requires directors to show that their defensive actions were "reasonable in relation to the threat posed."[29] The Court, per Justice Andrew Moore, wrote that developing a reasonable anti-takeover plan

> entails an analysis by the directors of the nature of the takeover bid and its effect on the corporate enterprise. Examples of such concerns may include: inadequacy of the price offered, nature and timing of the offer, questions of illegality, *the impact on "constituencies" other than shareholders (i.e., creditors, customers, employees, and perhaps even the community generally)*, the risk of nonconsummation, and the quality of

takes the form of a direct appeal to shareholders to tender (sell) a controlling portion of their shares to the entity attempting the takeover.

27. 493 A.2d 946 (Del. 1985).

28. In the hilarious argot of corporate takeovers, the Mesa offer was a "two-tiered front end loaded" tender offer. *Id.* at 949. It was "structurally coercive" because Pickens offered a substantial cash premium for 51 percent of outstanding shares, while simultaneously announcing that after he gained control of Unocal he would merge Unocal with his Mesa firm under terms which would exchange the remaining 49 percent of outstanding Unocal shares for highly subordinated Mesa debt ("junk bonds"). *Id.* at 951. This was an offer that Unocal shareholders could not refuse. Shareholders would stampede to tender their shares and get in on the front-end of the two-step program, hoping to get the premium and fearing that they would get stuck on the back-end and receive nothing but the junk bonds. If shareholders could coordinate their activity they might all refuse to tender on the front-end, thus denying Pickens control of the firm and protecting themselves from the second-step junk-bond freeze-out. Unfortunately, highly dispersed, diversified shareholders cannot coordinate their activity. Hence, the question that *Unocal* presented was to what extent the Unocal board could take action to protect shareholders from the Pickens offer. *Id.* at 952-53.

29. *Id.* at 949. This standard is known as the "enhanced business judgment rule." *Id*. at 954. I discuss the business judgment rule generally in Sec. IV.D, *infra*.

securities being offered in the exchange.[30]

Remarkably, the court cited no cases or statutory authority for this proposition.[31]

This passage has been cited many times by scholars claiming that Delaware allows directors to attend to non-shareholder interests and does not require shareholder primacy in firm governance.[32] But that is wrong. The Delaware Supreme Court clarified its "'constituencies' other than shareholders" language in another prominent takeover case, also decided in 1985, *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*[33] A basic understanding of the facts of *Revlon* is necessary before its crucial doctrinal point on corporate purpose can be understood. Revlon was the target of a hostile takeover bid by prominent raider (or knight, depending on your perspective), Ronald Perelman. The Revlon board responded with a series of defensive maneuvers. One of the things it did was offer its own shareholders the opportunity to exchange shares of Revlon stock for debt notes with a high interest rate. Like many debt instruments, the notes came with certain promises (covenants) restricting the firm's subsequent business dealings. The covenants were meant to assure that the debt would be paid. The company offered to exchange these debt notes for up to 10 million shares, and the exchange was fully subscribed. The board hoped that the exchange would both mollify frustrated shareholders (who, like Perelman, believed their Revlon stock was underperforming) and ward off Perelman, who they hoped would no longer want the company after it was burdened by the debt and the debt covenants.[34]

Perelman was not dissuaded. He continued to increase his offer price for the

30. *Id.* at 955 (emphasis added).

31. Perhaps even more remarkably, the Court did, immediately after the passage quoted, cite to an obscure piece of unpublished scholarship by two corporate law practitioners that made reference to directors appropriately giving attention to multiple stakeholders in a takeover context: Martin Lipton and Andrew R. Brownstein, Takeover Responses and Director Responsibilities: An Update, A.B.A. NAT'L INST. ON THE DYNAMICS OF CORP. CONTROL 7 (Dec. 8, 1983) (on file with author). Unocal, 493 A.2d at 955. The Lipton and Brownstein piece was later published in substantially altered form in Business Lawyer. 40 BUS. LAW. 1403 (1985). Still more remarkably, the published version of Lipton and Brownstein's piece omitted the crucial "constituencies other than shareholders" language that the *Unocal* court had borrowed from the unpublished version of the piece for its infamous passage. *Id.* Neither Lipton nor Brownstein recall any specific reason for dropping the "constituencies other than shareholders" language between the draft and the published version. E-mail from Martin Lipton & Andrew R. Brownstein, to David G. Yosifon, Associate Professor, Santa Clara University School of Law (June 22, 2012) (on file with author).

32. *See infra* Sec. IV (reviewing scholarship).

33. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1985).

34. *Id*. at 176-79.

company. Intent on not allowing Revlon to fall into Perelman's hands, the directors cut a deal to sell the firm to the board's preferred suitor, Forstmann Little & Company, a private equity firm. Forstmann, the board concluded, had offered a fair price for the company, and had also promised to support at full value the debt notes that the board had exchanged for outstanding stock. Perelman's bid contained no such promise. To secure Forstmann's bid, the board also granted Forstmann a "lock-up" worth hundreds of millions of dollars if the firm ended up being sold to anyone else. Perelman and other Revlon shareholders filed suit to enjoin the Forstmann deal, claiming that it violated the board's obligations to the shareholders by unnecessarily and unreasonably ending an active bidding war for the company.

The board admitted that its deal with Forstmann was in part motivated by its desire to protect the noteholders.[35] The board claimed that such a motive was proper under *Unocal*, which stated that in charting the firm's course through a takeover, directors could consider an offer's "impact on 'constituencies' other than shareholders (*i.e.*, *creditors*, customers, employees, and, perhaps, even the community generally)."[36] The Delaware Supreme Court took this opportunity to clarify its *Unocal* language. This time Justice Moore laid down the law in no uncertain terms. The introduction to the *Revlon* opinion states that the Court would "address for the *first time* the extent to which a corporation may consider the impact of a takeover threat on constituencies other than shareholders."[37] This framing of the discussion repudiates the view that the Court had *already* addressed the other-constituencies issue in any substantive way in *Unocal*. The *Revlon* opinion then asserts that "while concern for various corporate constituencies is proper when addressing a takeover threat, that principle is limited by the requirement that there be some *rationally related benefit accruing to the shareholders*."[38] The Court reiterates this later in the opinion:

> The Revlon board argue[s] that it acted in good faith in protecting the noteholders because *Unocal* permits consideration of other corporate constituencies. Although such considera-

35. *Id.* at 176 (emphasis added).

36. Unocal, 493 A.2d at 955. The Revlon Board was represented by, *inter alia*, Martin Lipton and Andrew Brownstein, who had written the unpublished article that the *Unocal* court had cited in connection with its "'constituencies' other than shareholders" language. *See* Revlon, 506 A.2d 173.

37. Revlon, 506 A.2d at 176 (emphasis added).

38. *Id*. (emphasis added).

> tions may be permissible, there are fundamental limitations upon that prerogative. A board may have regard for various constituencies in discharging its responsibilities, provided there are rationally related benefits accruing to the stockholders. However, such concern for non-stockholder interests is inappropriate when an auction among active bidders is in progress, and the object no longer is to protect or maintain the corporate enterprise but to sell it to the highest bidder.[39]

*Revlon* thus clearly states the law in Delaware. Boards can attend to the interests of non-shareholders when the board believes that doing so will ultimately serve shareholders. However, boards may not attend to the interests of non-shareholders when those interests are not rationally related to shareholder interests. Remarkably, the Delaware Supreme Court cites no authority for its "rationally related benefits accruing to the shareholders" proposition, other than *Unocal*.[40]

In *Unocal* the board was allowed to repel a hostile takeover bid in order to protect its own vision for the future of the company. The board believed its long-term plans would prove more profitable to its shareholders than the short-term gains offered by Mesa's tender offer. In making their decision to fight Mesa, it was appropriate for Unocal's board to consider how its plans would impact workers, creditors, customers, even the community at large, since all these constituencies were relevant to the firm's long-term plans for making the company profitable. Consideration of these constituencies is therefore entirely appropriate for a going concern. However, the only permissible *reason* for considering these constituencies is their relationship to the shareholder interest. In contrast, the *Revlon* board accepted that there would be no future, no tomorrow, for the company or its shareholders. The company was going to be bought by either Perelman (the board feared) or Forstmann (the board hoped). Whoever bought Revlon was going to cash out the shareholders, bust up the company, and sell off its parts. Whether Perelman or Forstmann took control of the firm, the shareholders were going to get cash for their stock, and would have no future stake in the company. In this scenario it was entirely irrelevant how the board's actions would impact non-shareholding constituencies like creditors, workers, or customers, because the impact on those constituencies would not be relevant to any future shareholder interest. Any consideration of non-shareholders in that context would not be "rationally related" to the directors'

39. *Id.* at 182.
40. *Id.*

abiding obligation to attend exclusively to shareholder interests.

*Revlon* left no doubt on this subject. But a recent case, *eBay v. Newmark* (2010), again makes the point in language that is even clearer.[41] *eBay* is like *Dodge v. Ford* for the 21st century, in Delaware. One of the three founders of craigslist, Inc., the online classifieds site, sold his craigslist stock to eBay, Inc., in a complicated transaction that the other two craigslist founders had countenanced. Later it became clear that while eBay expected to be actively involved in shaping craigslist's future, the two remaining founders wanted eBay to be a passive investor. In their capacity as directors, the remaining founders undertook a series of maneuvers seeking to limit eBay's influence in craigslist, and to assure that control of the company remained in their hands and would pass to their heirs. eBay sued. Using a litigation playbook they may have ill-advisedly found on their own website, the craigslist founders explicitly, proudly, defended their machinations as necessary to protect the public-service orientation of craigslist and keep it from becoming too focused on profit-making.[42]

Not on Chancellor Chandler's watch. He wrote:

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

41. eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1 (Del. Ch. 2010).
42. *Id*. at 6-22.

> ards include acting to promote the value of the corporation for the benefit of its stockholders. The "Inc." after the company name has to mean at least that. Thus, I cannot accept as valid for the purposes of implementing the Rights Plan [i.e., Jim and Craig's entrenchment plan] a corporate policy that specifically, clearly, and admittedly seeks *not* to maximize the economic value of a for-profit Delaware corporation for the benefit of its stockholders—no matter whether those stockholders are individuals of modest means or a corporate titan of online commerce.[43]

Remarkably, Chandler did not cite a single case, statute, or piece of scholarship to support his conclusion. As with the *Dodge* court in Michigan, the proposition seemed so obvious and fundamental to Chandler that it needed no citation. Those who prefer to have one now have *eBay*.

The clarity of Delaware case law on corporate purpose helps to explain, or at least give meaning to, the relative silence on the issue in the Delaware statute. With the help of its active Corporate Law Committee, the Delaware Legislature is very alert to developments in the interpretation of its corporate code and has not been shy about responding to unsatisfactory judicial holdings with legislative amendments.[44] The failure of the legislature to do so in the area of corporate purpose must be read to express legislative acquiescence in that judicial conclusion.

## III. *AB PARIETEE*: JUDICIAL EPISTLES

At a recent corporate law symposium, Professor William Bratton remarked that if you spend any significant time tilling the fields of corporate law scholarship you will inevitably develop a personal relationship with Delaware jurists.[45] I was slightly chagrined by this comment, since I theretofore had thought I was something special for having gotten to know personally several Delaware jurists myself, mostly through visits they have made to my home institution, some 3000 miles from their docket. Nevertheless, I knew he was right. Delaware jurists are interested in the work of corporate law scholars and

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

44. For example, the Delaware legislature adopted the exculpatory provisions of §102(b)(7) in direct response to the Delaware Supreme Court (seemingly) expanding duty of care liability in *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985).

45. William Bratton, Remarks at the Seattle University School of Law Adolf A. Berle, Jr. Center of Corporations, Law & Society Symposium on Theories of the Firm (Jan. 13, 2012).

they are committed to being part of the scholarly conversation. But, as Bratton concluded: "they are never contained by us."[46] Considering it part of their calling to be ambassadors for Delaware corporate law, these jurists travel far and often, speaking before many audiences about their courts and their jurisprudence, defending, explaining, and rallying support for their prized institution. And when you hear Delaware jurists speak, they make no bones about the fact that Delaware law requires corporate directors to pursue the interests of shareholders, and allows them to do nothing else.

Leo E. Strine, Jr. became the newest Chancellor of the Delaware Court of Chancery in June of 2011, after serving as a Vice Chancellor since 1998.[47] Strine has long been an active off-the-bench analyst and booster of Delaware corporate law.[48] In March of 2011, just before being elevated from Vice Chan-

46. *Id.*

47. *See Judicial Officers of the Court of Chancery*, DELAWARE STATE COURTS, http://courts.delaware.gov/chancery/judges.stm (last visited July 3, 2012). Strine succeeds former Chancellor William Chandler, III, who is now a partner at Wilson, Sonsini, Goodrich, & Rosati. *See Chancellor William B. Chandler III*, WILSON SONSINI GOODRICH & ROSATI, http://www.wsgr.com/wsgr/DBIndex.aspx?SectionName=attorneys/BIOS/12348.htm (last visited July 3, 2012).

48. Recently the Delaware Supreme Court admonished Chancellor Strine for using his judicial opinions as a vehicle to express his personal views on business law. In *Auriga Capital Corp. v. Gatz Props*., 40 A.3d 839, 849-51 (Del. Ch. 2011), Strine opined that Delaware's LLC statute imposed fiduciary obligations on LLC managers by default. Whether that really is the default rule in Delaware is a controversial question, but it was *not* at issue in the *Gatz* case, where all parties admitted that their LLC agreement expressly provided for fiduciary obligations to be imposed on the firm's managers. In upholding the Chancellor's disposition of the case, the Supreme Court criticized Strine for unnecessarily expressing his views on the default rule issue and for, in the Supreme Court's words, "hubristically" suggesting that it would be imprudent for the Delaware Supreme Court to depart from his interpretation, given that it is the working assumption of practitioners. Gatz Props., LLC v. Auriga Capital Corp., No. 148, 2012 WL 5425227, at *10 (Del. Nov. 7, 2012). In an unmistakably displeased tone, the Supreme Court wrote:

> We remind Delaware judges that the obligation to write judicial opinions on the issues presented is not a license to use those opinions as a platform from which to propagate their individual world views on issues not presented. . . . To the extent Delaware judges wish to stray beyond those issues and, without making any definitive pronouncements, ruminate on what the proper direction of Delaware law should be, there are appropriate platforms, such as law review articles, the classroom, continuing legal education presentations, and keynote speeches.

*Id.* While Strine may have overdone it by suggesting that the Delaware Supreme Court should not exercise its authority to have the final say over what the law is in Delaware, it would be most unfortunate if the *Gatz* kerfuffle were to dampen the freewheeling, oft amusing, oft profound, excurses from which corporate lawyers and scholars have long benefitted in Chancery opinions. *See also generally* Edward B. Rock, *Saints and Sinners: How Does Delaware Corporate Law Work?*, 44 U.C.L.A. L. Rev. 1009 (1997) (emphasizing the important role of non-binding, but nevertheless influential, criticism of corporate practice in Delaware's judicial opinions).

cellor to Chancellor, Strine gave a lecture at the University of Western Ontario, which he titled, "Bailed Out Bankers, Oil Spills, Online Classifieds, Dairy Milk, and Potash: Our Continuing Struggle with the Idea that For-Profit Firms Seek Profit."[49] He subsequently published the speech in the Wake Forrest Law Review, dropping the pre-colon portion of the title in the published version.[50] As the title of his piece suggests, Strine argues that people should not be surprised when for-profit corporations externalize costs to non-shareholders while pursuing profits for shareholders. Such externalization, Strine candidly states, is entirely predictable, given the structure of corporations and the law orienting their conduct.[51]

Strine is "weary of the naiveté" with which even educated, worldly people continue to talk about corporations. In his view

> [t]he continued failure of our societ[y] to be clear-eyed about the role of the for-profit corporation endangers the public interest. Instead of recognizing that for-profit corporations will seek profit for their stockholders using all legal means available, we imbue these corporations with a personality and assume they are moral beings capable of being 'better' in the long run than the lowest common denominator. . . . In the end, policy makers should not delude themselves about the corporation's ability to police itself; government still has a critical role in setting the rules of the game.[52]

Normatively, Strine's goal in *Our Continuing Struggle* is to encourage citizens and policymakers to stop wringing their hands, wishing and hoping that corporations would behave better, and instead turn their energies towards developing more fulsome governmental regulation that can constrain the socially deleterious projects that corporations will inevitably undertake. Of course, "we" also tend to "imbue" "government" with "personality" and expect it to operate in a manner better than the "lowest common denominator." It is far from clear that such a view of government is wise. As I explain in Section V, *infra*, I find this prescription an implausible salve to the externalizing condition Strine accurately diagnoses. I instead advocate a reform of internal corporate governance standards that will require broader attention by corporate boards to non-

49. Leo E. Strine, Jr., *Our Continuing Struggle with the Idea that For-Profit Firms Seek Profit*, 47 WAKE FOREST L. REV. 135 (2012).
50. *Id.*
51. *Id.* at 135-36.
52. *Id.*

shareholder interests. The point for present purposes, however, is to witness how certain Leo Strine, *the* Chancellor of the Delaware Court of Chancery, is that the corporate law over which he presides requires directors to run firms in the best interests of shareholders.[53]

Doctrinal analysts who have doubted the importance of *Dodge v. Ford* should at least be troubled to find that Strine commits a section of his paper to that famous case. The most important doctrinal exegesis he draws from *Ford* comes in a footnote:[54]

> It is, of course, accepted that a corporation may take steps, such as giving charitable contributions or paying higher wages, that do not maximize corporate profits currently. They may do so, however, because such activities are rationalized as producing greater profits over the long-term.[55]

He then interprets Delaware case law in a manner that fully accords with my interpretation in the previous section. Citing *Unocal*, Strine states that "when a corporation is ongoing, it may consider the interests of other constituencies in pursuing a long term course to maximize profits."[56] However, Strine continues, "when there is no long-term, as when a sale is inevitable, directors must maximize value for the stockholders immediately."[57] The footnote ends where this inquiry must ultimately end: "These cases, when read together, mean stockholders' best interest must always, within legal limits, be the end. Other constituencies may be considered only instrumentally to that end."[58] It cannot be put more plainly than that.

Strine also dedicates a section of his paper to the *eBay* case, noting that it has "striking similarities to *Dodge*."[59] He approvingly quotes Chancellor Chandler's statement in that case that directors cannot "defend a business strategy that openly eschews stockholder wealth maximization — at least not con-

53. Strine does not address scholarship arguing the contrary position, which I address *infra* Sec. IV.
54. Indeed, it is so obviously the most important doctrinal work in the piece that it seems perverse for him to put it in a footnote, unless he is exploiting the perverse instinct of academics to search for the best material below the line (as it were).
55. Strine, *supra* note 49, at 147 n. 34.
56. *Id.*
57. *Id.*
58. *Id.*
59. *Id.* at 148.

sistently with the directors' fiduciary duty under Delaware law."[60] Strine calls this a "rather expected statement."[61]

## IV. THE SCHOLARLY CONFUSION

In this section I attempt to address the major arguments made by corporate law scholars who deny that the law of Delaware requires shareholder primacy in firm governance. To explain the interpretive problems that I see, I must showcase each step of these scholars' arguments, following them down to their footnotes, and past their footnotes, into the material they quote or cite. It is my hope that the stakes will make it worth the pain (in the reader's brain or bottom) of following this staking all the way down. I do not attempt to review every piece of scholarship on this subject. Both aspects of the time-space continuum preclude such an exhaustive review. I hope that my treatment of the major and recurring analytic moves addressed here can be deployed to analyze the same or similar moves made in other scholarship, or future scholarship, on this question.

Before beginning this review, I want to sincerely acknowledge my intellectual debt to each of the scholars treated here. On many other issues, and especially on their normative conclusions, I agree with them entirely. Much of what I know about corporate law I have learned from these authorities. In other arts the sincerest form of flattery is imitation. In ours it is critique.

### *A. Misinterpreting Unocal, Revlon, and Their Progeny*

One of the most prominent corporate law scholars to reject shareholder primacy as a description of Delaware corporate law is Professor Lynn Stout of Cornell Law School. In 2008 Stout published an essay provocatively titled, *Why We Should Stop Teaching* Dodge v. Ford.[62] She expanded that essay's arguments into a book, *The Shareholder Value Myth*, published in 2012.[63]

In her book, Stout invokes *Unocal* for her central conclusion that "the Delaware Supreme Court has stated that in weighing the merits of a business transaction, directors can consider 'the impact of "constituencies" other than shareholders (i.e., creditors, customers, employees, and perhaps even the community

60. *Id.* at 149.
61. *Id.*
62. Stout, *supra* note 19.
63. STOUT, *supra* note 3.

generally).'"[64] Inexplicably, Stout never follows up on this *Unocal* presentment with *Revlon*'s clarification. In fact, she *never* quotes the Delaware Supreme Court's crucial statement in *Revlon* that there must be "rationally related benefits accruing to the stockholders"[65] before the considerations noted in *Unocal* would be permissible.

Stout does discuss *Revlon*, but, like many scholars, she misconstrues its point. Stout argues that *Revlon* stands for the proposition that directors are *only* obligated to maximize shareholder value when a firm is about to be sold. Since in *Revlon* the shareholders were going to receive cash in exchange for their shares, she rightly acknowledges "[t]hat meant there would be no public corporation whose long-term interests the board might consider."[66] She also rightly states that the "Delaware Supreme Court held that, under the circumstances, the business judgment rule did not apply and Revlon's directors had a duty to get the public shareholders (soon to be ex-shareholders) the best possible price for their shares."[67] But from this she draws the *non sequitor* that, "[i]n other words, it is only when a public corporation is about to stop being a public corporation that directors lose the protection of the business judgment rule and must embrace shareholder wealth as their only goal."[68]

In terms of formal logic, Stout has committed the fallacy of "denying the antecedent."[69] For the logical statement, "if A, then B" it is a fallacy to conclude "not A, therefore not B."[70] In *Revlon*, the Delaware Supreme Court held that if [A] the firm is for sale, then [B] directors must maximize profits. Stout concludes from this that if the firm is not for sale, directors do not have to maximize profits. But this does not follow as a matter of logic, and it is not *Revlon*'s teaching. It is worth revisiting *Revlon*'s crucial passage in full:

> The Revlon board argued that it acted in good faith in protecting the noteholders because *Unocal* permits consideration of other corporate constituencies. Although such considerations may be permissible, there are fundamental limitations upon

64. *Id.* at 29.
65. Revlon, 506 A.2d at 176.
66. STOUT, *supra* note 3 at 31.
67. *Id.*
68. *Id.*
69. *See* HOWARD KAHANE, LOGIC AND PHILOSOPHY: A MODERN INTRODUCTION 300 (6th ed. 1990).
70. *Id.*

> that prerogative. A board may have regard for various constituencies in discharging its responsibilities, provided there are rationally related benefits accruing to the stockholders. However, such concern for non-stockholder interests is inappropriate when an auction among active bidders is in progress, and the object no longer is to protect or maintain the corporate enterprise but to sell it to the highest bidder.[71]

The statement that there must be "rationally related benefits accruing to the stockholders" is directly connected to the Court's discussion of its holding in *Unocal*. The phrase, "rationally related benefits accruing to the stockholders" is given as an explanation of the "fundamental limitations" that attend *Unocal*'s invitation to consider the interests of non-shareholders. It is only *after* connecting the "rationally related benefits" language to *Unocal* that the *Revlon* Court moves on to explain how this teaching operates in *Revlon's* auction setting. These words, in this order, cannot be interpreted to mean that the "rationally related benefits" language applies *solely* when a company is being sold to the highest bidder. *Revlon*, therefore, holds that so long as a business is a going concern Delaware will defer to the directors' discretion in determining *how* to maximize shareholder value. This, the *Unocal* and *Revlon* courts recognize, may often include being good to non-shareholders. However, in the last period, where the shareholders will have no continuing interest in the firm, directorial attention to the interests of non-shareholders cannot possibly bear on shareholder interests, and, therefore, at the moment, attention to non-shareholder interests would necessarily violate the one duty that is always in place: the duty to the shareholders.

Most surprisingly, Stout does not even discuss *eBay*, wherein Chancellor Chandler explicitly condemned corporate directors who stated that their intention was something other than to "maximize the economic value of a for-profit Delaware corporation for the benefit of its stockholders."[72] This omission is particularly troubling given that Stout's book is aimed not just at scholars and corporate insiders, but also "informed laypersons,"[73] who would have no reason to note or decide for themselves about the significance of omitting a case so obviously relevant to the discussion.

Professor Einer Elhauge of Harvard Law School makes a positive ar-

71. Revlon, 506 A.2d at 182 (internal citations omitted).
72. *eBay Domestic Holdings*, 16 A.3d 34. *See also supra* notes 41-43 and accompanying text (discussing *eBay*).
73. STOUT, *supra* note 3, at vi.

gument about Delaware law that would look to extend and deepen Stout's basic claim.[74] Yet it proves no more persuasive in the end. Elhauge argues that norms and morality often provide a socially useful constraint on business dealings.[75] He argues that corporate law should (and, he claims, does) provide discretion for directors to sacrifice profits in the interests of non-shareholders, like workers, consumers, or the environment, in the same way that social norms and morality typically constrain the profit-seeking behavior of individuals engaged in business activity outside of the corporate form (*e.g.*, in mom and pop fashion). In the context of publicly traded corporations, however, shareholders are too dispersed from corporate operations to feel the shame or honor that prods non-corporate business practice in desirable ways, and so corporate law allows directors to stand in for that affective role, which they can plausibly do since they are publicly associated with the corporate activity. This is a nifty argument. But it flounders when Elhauge tries to make it cohere with Delaware case law.

In defending his claim, Elhauge first cites *Unocal* for the proposition that Delaware allows directors to "reject a takeover bid based on 'the impact on "constituencies" other than shareholders.'"[76] Yet he, too, fails to connect this language to the clarification in *Revlon*, which readers of this Article by now know requires that such considerations be "rationally related"[77] to shareholder interests. In fact, Elhauge does not mention *Revlon* at all until 85 pages have separated it from his *Unocal* assertion, and even then he does not modify his claim about what *Unocal* allows.[78]

The second piece of evidence Elhauge offers in support of his positive claim comes in the form of a quote pulled from a different sentence in *Unocal*. He writes (his quote from *Unocal* put here in italics): "Delaware case law also explicitly states that '*stockholder interests*' are '*not a controlling factor.*'"[79] The fuller passage from which these quotes are drawn, however, reveals that they have nothing whatsoever to do with the Court's view of the relative standing of shareholder and non-shareholder interests in the board's responsibilities.

74. *See* Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest,* 80 N.Y.U. L. REV. 733 (2005).
75. *Id.* at 764.
76. *Id.*
77. Revlon, 506 A.2d 182.
78. Elhauge, *supra* note 74, at 849.
79. *Id.* at 764-65 (emphasis added).

The full *Unocal* sentence from which Elhauge plucked his phrases reads:

> While not a controlling factor, it also seems to us that a board may reasonably consider the basic stockholder interests at stake, including those of short term speculators, whose actions may have fueled the coercive aspect of the offer at the expense of the long term investor.[80]

The "basic" "stockholder interests" the Court is (somewhat inelegantly) referencing are whether the stockholder has been a long-term investor, which is one kind of interest, or is a short-term speculator, which is another. In a footnote to its sentence the Court cites studies finding that some target companies that resisted takeovers eventually traded at a higher price than the price offered in the hostile bid.[81] This footnote buttresses my interpretation that in the phrases Elhauge quotes, the *Unocal* Court is simply noting that critically examining the sometimes competing interests of long-term vs. short-term shareholders is an appropriate thing for corporate boards to do in the takeover context. Deciding how to manage that tension is within the board's discretion (i.e., there is nothing in the competing interests of these groups that is "controlling."). The sentence in question comes in the *Unocal* opinion right after the sentence containing the infamous "constituencies" language. Under Elhauge's interpretation, the second sentence would be duplicative of the sentence that precedes it. It would add nothing to the sentence that precedes it. On my reading, the sentences are non-duplicative and coherent. To read *Unocal* as holding that directors may pursue non-shareholder interests that are unrelated to stockholder interests because "stockholder interests" are not a "controlling factor" is to misread *Unocal*.

The third piece of evidence Elhauge offers to substantiate his claim that Delaware does not require shareholder primacy in firm governance comes from *Mills Acquisition Co. v. Macmillan, Inc.*, a 1989 Delaware case in which Macmillan's directors were found to have violated their fiduciary duties in the course of selling the company, by favoring a bidding group comprised of incumbent managers and dealing unfairly with a group of outside bidders who may have offered better terms.[82] Such dealing was wrongful, according to the Court, because, "*like any other business decision*, the board has a duty in the

80. Unocal, 493 A.2d at 955-56.

81. *Id.* at 956 n.11 ("There has been much debate respecting such stockholder interests. One rather impressive study indicates that the stock of over 50 percent of target companies, who resisted hostile takeovers, later traded at higher market prices than the rejected offer price.").

82. Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1264 (Del. 1989).

design and conduct of an auction to act in 'the best interests of the corporation and its shareholders.'"[83] In this important line the Court at once makes clear that the directors' responsibility is to the corporation and its shareholders, *and* that this duty is the same whether the company is operating as a going concern ("*any* other business decisions") or is in a final period (up for sale in "an auction"). But you would have to read *Macmillan* itself, or the present Article, to see that line. Elhauge does not cite it.

Instead, Elhauge ignores this clear statement from the text of *MacMillan* and looks to a footnote in the case when he writes (the language he quotes from the *MacMillan* footnote presented here in italics): "Delaware case law also holds that managers may rebuff tender offers based on '*any special factors bearing on stockholder and public interests*.'"[84] He goes on to argue that the *MacMillan* Court "also . . . stated that managers may base their rejection of a takeover bid on the '*effect on the various constituencies, particularly the stockholders*,' which implicitly indicates the analysis is not limited to the effect on shareholders."[85] The reason that the language Elhauge quotes here is from a *footnote* in *Mills Acquisition* is because it is dicta, with no direct bearing on the decision in the case, which involved a flubbed auction, not a decision to reject a tender offer. In any event, the footnote language Elhauge cites cannot bear the interpretation or import he enlists it to carry. The portion of the footnote that Elhauge quotes is simply the *Mills Acquisition* Court's summary of the rule set out in *Unocal*. Indeed, the Court pincites *Unocal*'s "constituencies" language after the lines Elhauge quotes. As I reviewed above, the Court has made clear that myriad factors, including other constituencies and public interests, are relevant to a firm's determination to reject a takeover bid and maintain the firm as a going concern, since such considerations may bear on the profitability of the firm. This is non-controversial. *Revlon*, however, makes clear that this invitation in *Unocal* is to be understood as requiring a "rational relation" to shareholder interests. There is nothing in the *Mills Acquisition* footnote that suggests that the interests of non-shareholders may be considered irrespective of, or when they conflict with, shareholder interests. This is especially so when the footnote is read in the shadow cast by the clear shareholder primacy language

83. *Id.* at 1287 (emphasis added).

84. Elhauge, *supra* note 74, at 765 (citing *Mills Acquisition*, 559 A.2d at 1285 n.35). Elhauge emphasized the "and" with italics; I have dropped the emphasis in order to emphasize the Court's usage.

85. *Id.* at 765 n.68 (citing *Mills Acquisition*, 559 A.2d at 1285 n.35)

in the text of the opinion itself, which I have relayed.

Finally coming to *Revlon*, Elhauge claims that "when corporate control is being sold, then that does trigger a duty to profit-maximize . . . . [b]ut the cases so holding emphasize that this profit-maximization duty applies only to such sales of corporate control and thus make clear that it does not apply otherwise."[86] I have already demonstrated that this is not true.[87] However, Elhauge's interpretation of *Revlon* is not even internally consistent with his overall positive vision of Delaware corporate law. Recall that Elhauge believes norms and morality can usefully constrain socially deleterious business activity, and he believes that Delaware generally allows for this constraint to operate in its corporate law. [88] Well, in the "last period" of a firm's life (e.g., when it is being sold) non-shareholder interests are particularly vulnerable, precisely because the firm no longer needs to be concerned with making future-profits oriented credible commitments to outsiders. The dislocations accompanying the bust-up of a going concern can devastate workers and destroy entire communities. If norms and morality really do constrain ordinary, non-corporate business behavior, we would certainly expect to witness that dynamic in last-period contexts. I am thinking (in made up fashion, like Elhauge) of the mom and pop owners of a deli who "take care" of the guy who worked their counter for 30 years when mom and pop sell their place and retire to Florida. I am thinking of the mom and pop who "look out" for their customers when selling their business as a going concern, refusing to sell unless the buyer makes commitments to maintain or service a product line after the sale. Yet, even Elhauge acknowledges that Delaware *forbids* these kinds of norms and ethics considerations in directorial decision-making when a company is being sold. If Delaware really blankets workers, consumers, and communities with the warmth of directorial attention in the days, weeks, and years before a sale of the firm is in the works, as Elhauge claims, then why would it yank it off and leave these groups cold at the very moment where they are most vulnerable to the (market) elements?

Elhauge's answer is that Delaware has to remove the directorial discretion to sacrifice profits in the public interest (that he claims generally exists) in last periods because at such moments directors are not constrained in their profit-sacrificing conduct, as they are while the business is a going concern, by the disciplining power of capital markets, product markets, labor markets, and the

86. *Id.* at 765.
87. *See supra* Section II.
88. Elhauge, *supra* note 74, at 739-56.

need to seek re-election to the board.[89] Freed from these constraints in the final period, he argues, directors might suddenly become too generous to non-shareholders at the expense of shareholders. Corporate directors might be far more generous than the non-corporate mom and pop in similar circumstances, because they are sacrificing other people's money, not their own.[90]

But this proves too little. By the time he reaches his "last period" analysis, Elhauge has already reviewed (and celebrated) case law in which Delaware courts affirmatively supervise corporate decisions and impose substantive "reasonableness" restrictions on directors' discretion, including, for example, in the charitable-giving context.[91] If Delaware really did consider it generally to be appropriate for directors to sacrifice profits in the public interest, then Delaware also could easily allow it in the takeover context, where it matters most, while imposing "reasonableness" parameters, since extra-judicial providers of reasonableness are non-functioning in that context.[92] After all, the takeover context is already one in which customary judicial deference yields to enhanced judicial scrutiny and Delaware courts take it upon themselves to ensure the "reasonableness" of directors' decisions to entrench and defend against takeovers, rather than give in and accept a takeover offer.[93] If it were really true that Delaware generally considers it appropriate for directors to sacrifice profits for non-shareholders, then we would expect Delaware to extend a reasonableness framework to the analysis of profit-sacrificing conduct in the sale of control context as well, where directors might be tempted to do too much of it. Instead we see that such considerations are completely forbidden.

My interpretation of *Revlon* is much more plausible: so long as a business is a going concern, Delaware gives all deference to the directors to determine how to maximize shareholder value, which very often may include being good to non-shareholders. However, in the last period, where the shareholders will have no continuing interest in the firm, directorial attention to the interests of non-

89. Elhauge, *supra* note 74, at 739-56.

90. *Id.* at 848-52.

91. I review corporate charitable giving *infra*, Section IV.C.

92. Of course they still function if the out-going directors hope to find themselves appointed or elected to the boards of other companies, a contingency that may be especially on their minds knowing that they will soon be out of a job at their incumbent firm. The threat of reputational sanctions also continues to operate on directors who may, in retirement, seek admission and comfortable membership in social clubs where faithful service to shareholders is valued. *Cf.* BAINBRIDGE, *supra* note 2, at 171-73 (discussing the role that reputational sanctions play in preventing directorial misconduct).

93. *See supra* Section II(B).

shareholders cannot possibly bear on shareholder interests, and therefore at that moment attention to non-shareholders would violate the directors' abiding duty to the shareholders.

Perhaps sensing that his *Revlon* analysis does not really add up, Elhauge pursues a strained interpretation of another important case to argue that actually, *even* in the last period, when the company is up for sale, Delaware authorizes directors to consider non-shareholder interests.[94] He examines the 1989 auction sale of RJR Nabisco,[95] in which a disinterested board chose to sell the company to the investment firm KKR (Kohberg, Kravis, Roberts & Co.) rather than a group of competing bidders comprised of the firm's incumbent managers. After a tense, complicated, high-stakes bidding process, the board weighed KKR's best offer, which the board's investment bankers valued at "approximately $108 to $108.50 per share,"[96] against the management team's best offer, which the company's bankers "were of the view . . . had a value of approximately $108.50-$109 per share."[97] The Court stated that "the Company's bankers . . . were of the view . . . that the two bids, were, so far as financial analysis could determine, substantially equivalent."[98] Nevertheless, Elhauge looks to make hay of the fact that Delaware countenanced the board's decision to accept the KKR bid and reject the management team's bid. He writes

> the fact is that, even as valued by the corporation itself, the two bids were not equal: The accepted bid had a value of $108-108.50 and the rejected bid a value of $108.50-$109.00. The corporation's own analysis thus indicated there was no chance the winning bid was worth more than the rejected bid. The best the corporation could say is that the difference in value was between $0 and $1. Accordingly, the rejected bid necessarily must have had higher expected value to shareholders. The decision effectively holds that, even in the auction context, management can go beyond considering only those nonshareholder interests that bear a rational relationship to shareholder value. Management can in addition conclude that consideration of nonshareholder interests overrides small dif-

94. Elhauge, *supra* note 74, at 851-52.

95. Excellently dramatized in the Emmy Award Winning HBO film, *BARBARIANS AT THE GATE* (1993).

96. In Re RJR Nabisco, Inc. S'holder Litig., Unpublished Opinion, 14 Del. J. Corp. L. 1132, 1137 (1989).

97. *Id.*

98. *Id.* at 1138.

> ferences in shareholder value, amounting to less than one percent of expected shareholder value, on the grounds that only "substantial" equivalence is required.[99]

This analysis might hold up if it were true, as Elhauge writes, that "as valued by the corporation itself, the bids were not equal."[100] But that is *not* true. The firm's *investment bankers* may have given the rejected bid a higher upper range than the accepted bid, by 50 cents. Of course the investment bankers also said the bids were "substantially equivalent," so their words conflicted with their numbers, unless 50 cents per share is insubstantial, which is really not their call. And that is the point. It is not their call. Under Delaware law, neither investment bankers nor law professors determine the value of a bid. The directors do that. Only by substituting "the corporation" for the "investment bankers" can Elhauge even plausibly claim that the *corporation* believed there was no chance the winning bid was worth more than the rejected bid. The corporation, as manifested by the board, was under no obligation to accept the investment bankers' word—or numbers—as final. Indeed, the board was obligated to make its own decision. Reading Chancellor Allen's summary of the vast array of attributes and contingencies that went into valuing the extremely complicated securities that comprised each bidder's offer—which included predictions about future market conditions—even the layperson can see that any dollar, or fraction of a dollar, figure put on the value of the securities was necessarily imprecise and speculative.[101] Determining the value of investment instruments of that complexity requires more than a calculator. It requires judgment. That judgment was the board's to exercise.

Unlike Revlon's board, the Nabisco directors "disclaim[ed] any motivation other than one to pursue the special duty that fell to them with diligence for the best interests of the shareholders."[102] Chancellor Allen concluded that this as-

99. Elhauge, *supra* note 74 at 851-52.

100. *Id.*

101. "Nor can the decision to prefer KKR's bid with . . . less nominal or face value per share be seen as so beyond the bounds of reasonable judgment as to raise an inference of bad faith in my opinion. The larger equity stub, the different future business plans of the two bidders, and the superior reset provision of KKR's proposed converting debentures, all provide a basis to support the notion that the choice was a rational one. That KKR as an acquirer presented antitrust questions or offered a somewhat lower proportion of cash simply presents an occasion for the exercise of judgment; the judgment reached does not, as indicated, appear so far afield as to raise a question of the motivation of the board." In Re RJR Nabisco, Inc. S'holder Litig., Unpublished Opinion, 14 DEL. J. CORP. L. 1132, 1138 (1989).

102. *Id.*

sertion was not pretext: "the decision. . . can in no event be seen as justifying an inference that those who made such a choice must have had some motivation other than the honest pursuit of the corporation's welfare."[103] Allen concluded that the board in good faith determined the KKR bid to be more valuable to the shareholders. Nothing in this jurisprudence implies that it was alright for the board to choose the KKR bid because there was a small difference in value for the shareholders and the KKR bid was better for other stakeholders, as Elhauge would have us believe. In the first period, in ordinary times, and in the final period, Delaware requires and allows directors to serve only the shareholders. The case law is clear on this point.

### *B. "The Corporation and Its Shareholders" Names Only One Stakeholder*

In several places, both in Delaware's statute and in its case law, we read that directors owe fiduciary obligations to "the corporation and its shareholders."[104] Some scholars have pointed to this formulation as evidence that directors do not owe their duties to shareholders alone, but can serve other stakeholders as well.

In an influential essay, David Millon offers the recurring "corporation and its shareholders" phrasing as one justification for his view that "Delaware law is not committed to shareholder primacy."[105] Millon argues that the formulation "must indicate that the corporation is something other than—and presumably more than—simply the shareholders alone. It could, for example, be thought of as an entity existing separately from its shareholder and other stakeholders, or perhaps as an aggregation of its various constituencies."[106] In a similar vein, Christopher Bruner recently published an article comparing corporate law in the United Kingdom and the United States and argued that while the UK is clearly focused on shareholders

> Delaware's courts have left the issue of corporate purpose considerably less clear, stating that directors owe duties of care and loyalty "to the corporation and its stockholders" simultaneously --a formulation reflecting deep-seated ambivalence re-

103. *Id.*

104. *See, e.g.*, Mills Acquisition, 559 A.2d at 1287 ("[T]he board has a duty . . . to act in 'the best interests of the corporation and its shareholders.'").

105. David Millon, *Two Models of Corporate Social Responsibility*, 46 WAKE FOREST L. REV. 523, 526 (2011).

106. *Id.*

> garding the degree to which shareholders' interests ought to dominate corporate decision-making in the United States.[107]

Andrew Gold also puts great emphasis on the fact that Delaware cases sometimes refer to duties owed to shareholders and sometimes to duties owed to shareholders and the corporation: "[b]ecause the interests of shareholders and the interests of the corporation will sometimes conflict," he argues that "this amounts to an indeterminate standard."[108] But what kind of conflict between the corporation and its shareholders does Gold have in mind? He gives no examples, neither from case law nor even a hypothetical. He references cases that have used the double formulation, but none of them describe a *conflict* between the corporation and its shareholders.[109] Gold says that "[t]he result is substantial ambiguity,"[110] but he does not show it. If Delaware (or even one coherent strain of Delaware thinking) held the view that "the corporation and its shareholders" comprised several stakeholders with cognizably divergent interests, we would expect to see the formulation used in case law with reference to at least a speculative tension between such groups. We would expect to see the courts saying or alluding to the idea that directors have to "balance" the interests of the corporation and its shareholders, or shareholders and other corporate stakeholders, or the like. Yet there is no such language in any case.[111]

As support for his proposition that there is ambiguity imbedded in the "corporation and its shareholders" formulation, Gold cites, but does not quote from,

107. Christopher M. Bruner, *Corporate Governance in a Time of Crisis*, 36 J. CORP. L. 309, 325 (2011). Bruner boldly states, as premise, that: "U.S. boards generally . . . have explicit latitude to consider the interests of other stakeholders, such as employees and creditors, in deciding how to respond to a hostile bid." *Id*. For this proposition Bruner string-cites the familiar cases, *Unocal*, *Revlon*, etc. However, neither his text nor his footnotes makes clear, as Delaware has, that the consideration of "interests other stakeholders" must be "rationally related" to advancing shareholder interests. Inexplicably, Bruner neither discusses nor cites *eBay*.

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

109. *See id.* at 1098 n. 43 (citing E. Norman Veasey and Cristine Di Guglielmo, *How Many Masters Can a Director Serve? A Look at the Tensions Facing Constituency Directors*, 63 BUS. LAW. 76, 764 n. 8 (2008) (collecting cases)).

110. Gold, *supra* note 108, at 1098.

111. Gold argues that Delaware jurisprudence evinces uncertainty, or at least inconsistency, with respect to what theory of the firm its corporate law adopts or expresses. *See id*. I concur with his central thesis. Different cases, sometimes different passages from the very same case, can be read to suggest that Delaware thinks of corporations as property, as an entity that is owned by the shareholders, on the one hand, or that the corporation is merely a nexus-of-contracts with shareholders enjoying a contract right making them the residual claimants, on the other. This ambiguity as to Delaware's theory of the firm, however, should not be confused with ambiguity about corporate governance doctrine.

an article written by former Delaware Supreme Court Chief Justice Norman Veasey (retired from the bench at the time of the article's writing) and Christine Di Guglielmo, entitled *How Many Masters Can a Director Serve? A Look at the Tensions Facing Constituency Directors*.[112] In their piece, Veasey and Di Guglielmo rely on a quote from an article by Professor Eric J. Gouvin, *Resolving the Subsidiary Director's Dilemma* (with the material that Veasey and Di Guglielmo quote from Gouvin rendered here in italics):

> Well-established law in Delaware and other jurisdictions holds that the directors of corporations owe fiduciary duties to both the corporation and its shareholders. The Delaware Supreme Court has recently stated that these duties are *'of equal and independent significance,'* but case law reveals that the directors' duty to the corporation as an entity usually predominates over their duty to the shareholders.[113]

But when you chase down the "of equal and independent significance" language that Gouvin himself quotes from a case called *Cede v. Technicolor*,[114] you find that that phrase is not used to describe a distinction between directors' obligations to the corporation and its shareholders. Instead, the "of equal and independent significance" language Gouvin cites specifies a distinction between the directors' duty of care, on the one hand, and the directors' duty of loyalty, on the other. The full passage from *Cede* reads as follows:

> The duty of the directors of a company to act on an informed basis, as that term has been defined by this Court numerous times, forms the duty of care element of the business judgment rule. Duty of care and duty of loyalty are the traditional hallmarks of a fiduciary who endeavors to act in the service of a corporation and its stockholders. Each of these duties is of equal and independent significance. In decisional law of this Court applying the rule . . . this Court has consistently given equal weight to the rule's requirements of duty of care and duty of loyalty."[115]

112. *See id.* (citing Veasey and Di Guglielmo, *supra* note 109, at 764 n. 8).
113. Veasey and Di Guglielmo, *supra* note 109, at 768 n. 19 (quoting Eric J. Gouvin, *Resolving the Subsidiary Director's Dilemma*, 47 HASTINGS L. J. 287, 294-95 (1996) (quoting Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 367 (Del. 1993)).
114. Cede & Co., 634 A.2d at 367.
115. *Id.*

The Court was repudiating the Chancery Court's confusing conflation of the care and loyalty analysis in the *Cede* litigation. The discussion had nothing whatsoever to do with any disjunction between duties owed to the corporation and its shareholders.

There are indeed some passages in some Delaware cases where "the corporation" and the "shareholders" are treated as meaningfully separate things. However, even where the distinction is seen as significant, the cases *never* suggest that directors have the right to do anything with or for the corporation other than manage it in the best interests of shareholders. The distinction that *is* made in the cases between "the corporation" and "its shareholders" emerges only in controversies over *who* gets to decide what is in the shareholders' best interest—shareholders themselves, or directors on behalf of shareholders. That is, the "corporation" and the "shareholders" become meaningfully distinct interests only with respect to questions of "who decides," rather than "what is decided." This is the sense in which the distinction is dealt with in *Grand Met Ltd. v. Pillsbury Co.*,[116] the Delaware case that most explicitly distinguishes between these interests. Grand Met had endeavored to wrest control of Pillsbury by means of a public tender offer for a controlling portion of Pillsbury shares. The Pillsbury board adopted a poison pill in an effort to stymie the takeover bid. Grand Met and Pillsbury shareholders sued to enjoin the board's defensive maneuver. Because Grand Met had made a tender offer directly to the Pillsbury shareholders for *their* stock, and because the all-cash for all-shares offer was not structurally coercive, the Chancery Court concluded that there was no "danger to policy or effectiveness of the Pillsbury *corporation* (that is, the *company* as *company*) if the Rights were redeemed and/or if Grand Met succeeds in its Tender offer. Whatever danger there is relates solely to shareholders and that concerns price only."[117] In a similar context, the Chancery Court in *TW Services, Inc. v. SWT Acquisition Corp.* opined that "tender offers essentially represent the sale of shareholders' separate property and such sales-even when aggregated into a single change in control transaction-require no 'corporate' action and do not involve distinctly 'corporate' interests."[118] The distinction then is between something that directors (usually) run for shareholders—

116. Grand Metro. Pub. Ltd. v. Pillsbury Co., 558 A.2d 1049 (Del. Ch. 1988).
117. *Id.* at 1056 (emphasis in original).
118. TW Servs., Inc. v. SWT Acquisition Corp., Civ. A. Nos. 10427, 10298, 1989 WL 20290, *1198 (Del. Ch. March 2, 1989).

the corporation—and something the shareholders (usually) run for themselves—their shares. But there is nothing in this treatment that suggests that with respect to their duties to the corporation (the "company as company") directors have any right to run it in a manner that benefits other stakeholders at the expense of shareholders.

After *Grand Met* and *TW Services*, Delaware's doctrine developed to, under some circumstances, supply directors with the authority to defend against even non-coercive cash tender offers, thus threatening to collapse altogether the jurisprudential distinction between corporate and shareholder interests that I have just outlined. In *Paramount Communications, Inc. v. Time, Inc.*,[119] for example, the Delaware Supreme Court allowed the Time board to adopt defensive measures that would preclude Time shareholders from participating in a non-coercive, all-cash for all-shares tender offer by Paramount, Inc. The Court accepted the Time board's argument that allowing shareholders to tender to Paramount was disruptive of corporate policy. The Court opined that Time had developed a long-term business plan that would be prematurely terminated by the passing of control of the corporation to Paramount, *even through a tender offer*: "[W]e reject the argument that the only corporate threat posed by an all-shares, all-cash tender offer is the possibility of inadequate value."[120] There is a genuine conflict between *Grand Met* and *Paramount*, but the conflict is between whether shareholders get to decide what is in their best interests or whether directors get to decide it. The interests of non-shareholders—accept as they relate to shareholder interests—play no role in either decision or in the tension between them. There remains ample ambiguity in Delaware doctrine about when corporate boards have plenary authority over corporate decisions and when the board must yield to a contradictory will of the shareholders.[121] There is no question though that when the directors do act they must act in the best interests of the shareholders, even if their conception of the best interests of the shareholders may from time-to-time differ from the shareholders' opinion of what is best for themselves.

The "corporation and its shareholders" double formulation is a little obscure, but as this sub-section makes clear, it cannot plausibly be read as black

119. 571 A.2d 1140 (Del. 1989).

120. Paramount Comm., Inc. v. Time Inc., 571 A.2d 1140, 1142 (Del. 1989).

121. For example, *compare* Air Prods. and Chems., Inc. v. Airgas, Inc., 16 A.3d 48 (Del. Ch. 2011) (allowing directors to adopt a poison pill which had the effect of precluding voluntary shareholder participation in a non-coercive tender-offer) *with* Omnicare v. NCS Healthcare Inc., 818 A.2d 914 (Del. 2003) (enjoining directors' adoption of protective measures in connection with director's preferred merger agreement where such measures would preclude consideration of other offers for the firm).

letter support for mandatory or permissive multi-stakeholder governance. The better reading of “the corporation and its shareholders” formulation is that it emphasizes rather than detracts from the norm of shareholder primacy. If Delaware just said that directors had obligations to “the corporation” then we might fruitfully argue about which stakeholders count in Delaware’s conception of the corporation. The only formulation we get, however, is “the corporation and its shareholders.” Shareholders are the only stakeholder group that is singled out. We never see in Delaware jurisprudence, “the corporation and its workers,” “the corporation, its shareholders, and its workers,” or “the corporation and its stakeholders.” It is always, “the corporation and its shareholders.” The better interpretation of this phrase is to view it as expressing a unified, coherent set of obligations, rather than distinct, serial, or disjunctive ones. The directors’ attention is to be devoted to doing things aimed at increasing the value of the corporation (a distinct legal entity) for the shareholders. The cases cannot support any other construction.

### *C. Charitable Giving: Not an Exception to the Rule*

There is a provision in the Delaware statute which gives corporations the “power to . . . [m]ake donations for the public welfare or for charitable, scientific or educational purposes, and in time of war or other national emergency in aid thereof.”[122] When I began this project I was prepared to acknowledge the corporate charitable giving power as an exception to the rule of shareholder exclusivity in corporate governance. If the general powers that are granted to directors *already* included the power to advance the interest of multiple stakeholders and the public at large, then firms would already have the power to make charitable donations. The charitable giving exception thus brings the default rule of shareholder primacy into clearer focus. The fact that this explicit exception is necessary, I was going to argue, helps to prove the rule. The charitable donation power is also capped through judicial interpretation by a reasonableness standard.[123] I was going to point out that this substantive limitation on corporate choices differs markedly from the much broader latitude the courts give directors in the main, shareholder-focused sweep of their jobs.

But after studying the matter I am convinced that the corporate charitable

122. DEL. GEN. CORP. L. § 122(9).
123. *See infra,* text accompanying notes 130-139.

giving power, as interpreted under Delaware case law, represents no real exception or deviation from the fundamental rule of shareholder primacy. For starters, the provision granting firms the power to make charitable contributions comes ninth in a list of seventeen specifically enumerated powers that corporations created under the code "shall have."[124] Other powers include: the power of "(1) perpetual succession . . . "; the power to "(2) [s]ue and be sued . . . "; the power to "(3) appoint . . . officers and agents . . . and provide for them suitable compensation"; and the power to "(13) make contracts."[125] These are powers that all corporations have, but the question still remains as to what principle should govern the *exercise* of these powers. Although the corporation has the power to make contracts, directors may not cause the corporation to make contracts that advance the interests of suppliers while neglecting or harming the interests of the corporation and its shareholders. Similarly, although the corporation has the power to make charitable contributions, it may not use that power in a fashion that neglects or deviates from the abiding purpose of corporate governance, the interests of the shareholders. Many times it will benefit shareholders for firms to contract with suppliers, and it will also often be in the interests of shareholders for the firm to make donations for the public welfare.[126] In the 19th and early 20th centuries there was contradictory case law on the question of whether business corporations had the power to make charitable contributions, or whether such acts were *ultra vires*, beyond the powers of the firm to effectuate. The statute clarifies that firms may make donations. When and how they make them is governed by background fiduciary principles.

Still, the statutory language on charitable giving is at best ambiguous on the point of purpose. The key Delaware cases interpreting this statutory provision, however, clearly adopt a shareholder primacy view of the power. The leading cases on the issue are usually cited for the proposition that the Delaware judiciary has engrafted a "reasonableness" limitation on charitable giving which is not explicitly contained in the statute. While it would be odd to think

124. DEL. GEN. CORP. L. § 122.

125. *Id.* § 122(9). The twelfth enumerated power gives all corporations the power to "[t]ransact any lawful business which the corporation's board of directors shall find to be in aid of governmental authority." *Id.* § 122(12). This oddly worded provision has received no treatment in the case law and scant academic attention. *See* David G. Yosifon, *Corporate Aid to Governmental Authority: History and Analysis of an Obscure Power in Delaware Corporate Law*, __ U. ST. THOMAS L. REV. __ (2013) (forthcoming)(providing a comprehensive assessment of §122(122) which does not alter the doctrinal conclusions reached in the present article).

126. *See* WILLIAM A KLEIN, J. MARK RAMSEYER, AND STEPHEN M. BAINBRIDGE, BUSINESS ASSOCIATIONS 268 (7th edition, 2009)("§122(9) can be read merely as an authorization to make charitable contributions that serve the basic purpose of corporations, which is to maximize profit.").

that the legislature meant to authorize "unreasonable" charitable donations, the presumed consequence of the imposed "reasonableness" limitation is to introduce an element of objective, substantive review, rather than the ordinary process-only review that directors enjoy when making regular business decisions. The cases, however, have more to offer in terms of helping us understand the purpose and rightful exercise of the charitable giving power.

Delaware's first important case interpreting the charitable giving provision, *Theodora v. Henderson* (1969), responded to a complaint that the directors of Alexander Dawson, Inc., a holding company, had violated their fiduciary obligations to shareholders when they made a corporate gift of $528,000 to a charitable organization that ran a camp for under-privileged boys.[127] After quoting the Delaware statutory language giving corporations the power to make charitable contributions, the Court framed its inquiry into the propriety of the gift thusly:

> [C]ontemporary courts recognize that unless corporations carry an increasing share of the burden of supporting charitable and educational causes that the business advantages now reposed in corporations by law may well prove to be unacceptable to the representatives of an aroused public.[128]

From the start, the Court's emphasis is not on what charitable giving might do for the public interest, but rather, what corporate giving, or the absence of it, might mean for the public's tolerance of the "advantages" that corporations enjoy. After this introductory framing, the Court moves to a favorable discussion of a famous New Jersey case, *Smith v. Barlow*,[129] in which New Jersey corporate law was held to countenance a small gift that the Smith corporation had made to Princeton University. The *Theodora* court observed that the New Jersey court "noted that the gift tended to bolster the free enterprise system and the general social climate in which plaintiff was nurtured."[130]

In a bit of a non sequitor, the *Theodora* Court moves on from this discussion to state its conclusion that: "the test to be applied in passing on the validity

127. Theodora Holding Corp. v. Henderson, 257 A.2d 398, 404 (Del. Ch. 1969). The case actually involved myriad allegations of disloyal directorial shenanigans, but the charitable giving issue is the only one relevant here.
128. *Id.* at 404.
129. A.P. Smith Mfg. v. Barlow, 13 N.J. 145, 98 A.2d 581 (1953).
130. Theodora, 257 A.2d at 404.

of a gift such as the one here in issue is that of reasonableness, a test in which the provisions of the Internal Revenue Code pertaining to charitable gifts by corporations furnish a helpful guide."[131] (At the time the Internal Revenue Code allowed charitable contributions to be deducted as expenses up to 5% of taxable income;[132] today the IRC allows for deductions of up to 10% of income, although the average corporation contributes just 1.5% of its income to charity.[133]) Applying this newly announced standard to the Dawson firm's support of the camp for underprivileged boys, the Court again returns to the issue of purpose, and situates that purpose squarely in the idiom of shareholder primacy. Taking into consideration the tax benefits associated with the contribution, the Court concludes that "the contribution under attack can be said to have 'cost' all of the stockholders of Alexander Dawson, Inc. including plaintiff, less than $80,000, or some fifteen cents per dollar of contribution."[134] But why does the Court put the term 'cost' in shock quotes? If it is a cost to the shareholders, even just a small cost, then why not just write the word? The reason is that the Court views the contribution to be no cost at all, but rather a gain, to the shareholders:

> It is accordingly obvious, in my opinion, that the relatively small loss of *immediate* income otherwise payable to plaintiff and the corporate defendant's other stockholders, had it not been for the gift in question, is far out-weighed by the overall benefits flowing from the placing of such gift in channels where it serves to benefit those in need of philanthropic or educational support, thus providing justification for large private holdings, *thereby benefiting plaintiff in the long run*. Finally, the fact that the interests of the Alexander Dawson Foundation appear to be increasingly directed towards the rehabilitation and education of deprived but deserving young people is peculiarly appropriate in an age when a large segment of youth is alienated even from parents who are not entirely satisfied with our present social and economic system.[135]

131. *Id.* at 405.
132. *Id.*
133. *See* Elhauge, *supra* note 74, at 836-37.
134. Theodora, 257 A.2d at 405.
135. *Id*. (emphasis added). The opinion came down in 1969. In the final sentence quoted here the Court apparently is taking judicial notice that something was happening there, even if what it was was not exactly clear. *Cf.* BUFFALO SPRINGFIELD, FOR WHAT IT'S WORTH (Atco Records 1967).

As with attention to non-shareholders in ordinary business decisions, the corporate charitable contribution is acceptable because of the long-term benefits it may bring to shareholders. A fair reading of the admittedly under-written *Theodora* opinion must construe the "reasonableness" requirement in charitable contributions as having two components. The first component of reasonableness requires a reasonable relation to the shareholder interest, which explains the Court's repeated reference to long-term shareholder interests in the maintenance of a free and capitalistic society (in which corporations enjoy advantages only so long as the public remains un-"aroused").[136] The second component of reasonableness is magnitude, which explains the Court's reference to the tax code as guidance.

Consider a charitable contribution of less than 10 percent of taxable income that directors of a firm decide to make after deliberating and expressly concluding that the donation would *not* advance shareholder interests. In fact, the directors decide to make the donation after expressly determining that the donation would *undermine* shareholder interests. Suppose that the donation were made to a camp that was dedicated to teaching under-privileged children about the inadequacy of capitalism and democracy as means to overcoming the suffering of the American poor, and the unfairness of corporate advantages that benefit shareholders. Suppose further, if I don't have you yet, that the camp explicitly targets the donating firm for criticism, building its entire curriculum around case studies of the firm's alleged malfeasance. If shareholders challenged such a contribution, the directors' action might very well be held to be unreasonable, not because of the size of the charitable gift, but because the nature of the gift was not reasonably related to the shareholder interest (and the directors did not think it was). The exercise of the power to make charitable contributions is circumscribed by the fiduciary obligations that directors owe to the corporation and its shareholders.

The more commonly cited case on corporate charitable giving is *Kahn v. Sullivan*,[137] which is probably cited more often than *Theodora* not only because of its relative recency, but also because of its dramatic facts, which tend to raise the cackles of even the most rationally-ignorant, diversified equity investor who learns of them. *Kahn* involved a challenge to a decision by the directors of an energy company, Occidental, Inc., to donate $50 million for the

136.Theodora, 257 A.2d at 404.
137. 594 A.2d 48, 51 (Del. 1991).

construction of a museum to house the art collection of Occidental's retiring CEO. The Delaware Supreme Court accepted that the donation likely would pass the reasonableness test it established in *Theodora*. Usually unmentioned in references to *Kahn* is the Court's recognition of the Occidental board's explicit finding that the charitable contribution would benefit the corporation by improving its reputation in the local community and around the world. The charitable contribution was not made for the purpose of pure public interest. It was a studied extension of a long-standing business plan:

> For many years, the Board has determined that it is in the best interest of Occidental to support and promote the acquisition and exhibition of the Art Collection. Through Occidental's financial support and sponsorship, the Art Collection has been viewed by more than six million people in more than twenty-five American cities and at least eighteen foreign countries. The majority of those exhibitions have been in areas where Occidental has operations or was negotiating business contracts. Occidental's Annual Reports to its shareholders have described the benefits and good will which it attributes to the financial support that Occidental has provided for the Art Collection.[138]

In considering the funding of the museum project, the board solicited and was informed by a law firm which produced a ninety six page memorandum that, *inter alia*, "reviewed the authority of the Board to approve such a donation and the reasonableness of the proposed donation . . . [and] included an analysis of the donation's effect on Occidental's financial condition, [and] the potential for good will and other benefits to Occidental."[139] After deliberation, a Special Committee of the Board, comprised of independent directors (i.e., non-officer directors), "concluded that the establishment of the Museum, adjacent to Occidental's corporate offices in Los Angeles, would provide benefits to Occidental for at least the thirty-year term of the lease."[140]

138. *Id.*

139. *Id.* at 53-54.

140. *Id.* at 54. The procedural posture of *Khan* was complicated. The Delaware Supreme Court was reviewing the Chancery Court's acceptance of a negotiated settlement to a shareholder complaint about the charitable gift. While the Chancellor characterized the terms of the settlement as offering only small gains to the plaintiffs, he accepted the settlement as reasonable because he thought the plaintiffs had very little chance of succeeding on the merits. This is so because the Chancellor found that the charitable donation decision was disinterested, informed, and deliberate, and it was therefore "highly probable that . . . the decisions of the directors are entitled to the presumption of propriety afforded by the business

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The point is that while *Kahn* is usually cited for the proposition that corporations may make charitable contributions so long as they are reasonable, the firm at issue in *Khan* made its charitable contribution only after concluding that the donation was beneficial to the corporation. And that determination was relevant to the Supreme Court's upholding of the Chancery Court's assessment of the reasonableness of the donation. Neither Chancery nor the Supreme Court considered "reasonableness" to be merely a matter of dollar figure. Purpose remains relevant in the inquiry, and the purpose must be to advance the overarching charge of the directors, to serve the corporation and its shareholders. There are no Delaware cases after *Kahn* involving a corporate charitable giving analysis, and none of importance before *Theodora*.

### *D. Maximization is the Standard*

Another academic confusion about the law of corporate purpose involves the question of whether directors are required always to endeavor to "maximize" corporate profits, or whether they are permitted to do something less, even if one concedes that their decisions must always be intended to promote shareholder interests to some extent. Most Delaware cases describe the directors' duty as an obligation to "maximize" profits or pursue the "best" interest of the shareholders.[141] In some cases, however, the obligation is described as a duty to

judgment rule." *Id.* Delaware cases have not examined the odd relationship between the business judgment rule and the reasonableness inquiry in the charitable giving context. Typically, when a decision enjoys business judgment rule protection that means that the court will *not* be doing a reasonableness inquiry. The best reading is that business judgment rule protection in the charitable giving context means that plaintiffs will bear the burden of showing that the gift was unreasonable. The Delaware Supreme Court agreed with the Chancery Court's conclusion that the plaintiffs in *Kahn* could not meet that burden.

141. *See, e.g.,* Paramount v. Time, 1989 WL 79880, 58 USLW 2070 (Del. Ch. 1989) ("The legally critical question this case presents then involves *when* must a board shift from its ordinary *long-term profit maximizing* mode to the radically altered state recognized by the *Revlon* case in which its duty, broadly stated, is to exercise its power in the good faith pursuit of *immediate maximization* of share value.") (emphasis added); eBay Domestic Holdings, 16 A.3d at 35 ("I cannot accept as valid . . . a corporate policy that specifically, clearly, and admittedly seeks *not* to *maximize* the economic value of a for-profit Delaware corporation for the benefit of its stockholders.") (second emphasis added); TW Services Inc. v. SWT Acquisition Corp., 1989 WL 20290 (Del. Ch. 1989) ("Thus, broadly, directors may be said to owe a duty to shareholders as a class to manage the corporation within the law, with due care and in a way intended to *maximize* the long run interests of shareholders.") (emphasis added); Katz v. Oak Industries, 508 A.2d 873, 879 (Del. Ch. 1986) ("It is the obligation of directors to attempt, within the law, to *maximize* the long-run interests of the corporation's stockholders; that they may sometimes do so "at the expense" of others . . . does not for that reason constitute a breach of duty) (emphasis added); Mills Acquisition, 559 A.2d at 1287 ("Thus, *like any other business decision*, the board has a duty

manage the corporation "for the benefit of the shareholder owners,"[142] with the maximization qualifier dropped. And then there is *Revlon*'s language, which states that attention to non-shareholders is allowed when there are "rationally related" benefits to shareholders.[143] Sometimes shareholder primacy skeptics will claim that the inconsistent application of the "maximization" qualifier indicates that in the going-concern condition directors may steer the corporate ship in a manner that actively advances non-shareholder interests so long as *some* profits are involved for shareholders. On this view, Delaware allows directors to choose a less profitable course over a more profitable one, so long as the course is intended to give some benefit to shareholders.

This is not a plausible interpretation of Delaware law. To clarify this particular confusion it will serve first to reflect on the limited utility of the word "maximization" in discussions of human behavior. A highly stylized version of economics posits that humans are rational actors and will predictably act in such a manner as to "maximize" their utility or welfare, however the individual actor defines it.[144] More realistic versions of economics appreciate that human rationality is "bounded" by limited cognitive capacity, limited time, and other frailties of the fallen condition.[145] "Boundedly" rational actors cannot hope to "maximize" their welfare in the sense of achieving what a perfectly rational version of themselves could do.[146] Knowing that they cannot hope to achieve maximization, boundedly rational actors will routinely consider it prudent to set

in the design and conduct of an auction to act in 'the *best* interests of the corporation and its shareholders.'") (both emphases added). The phrase "long-term" in the context of this case law essentially refers to a time-horizon that is other than immediate. *Revlon* makes clear that, when the company is being sold and shareholders left with no continuing interest in the firm, directors have an obligation to maximize profits "immediately." "Long-term" by contrast refers to the going-concern condition, in which profits are to be taken in a time-frame decided upon by directors acting in good faith. "Long-term" in this sense most certainly does not mean over a long period of time, just as surely as it does not mean that the directors must look to profits over a 100 year period instead of, say, a 20 year period. I do not think any corporate law scholar seriously argues that long-term means anything other than non-immediate and at the discretion of the directors, and so I do not pursue the point further here. However, anyone unconvinced on this point may be indirectly persuaded of the correctness of this interpretation by the arguments relating to "maximization" in the remainder of this section.

142. North Am. Catholic Educ. Programming, 930 A.2d 92, 101 (Del. 2007) (quoting Malone v. Brincat, 722 A.2d 5 (Del. 1998).

143. Revlon, 506 A.2d at 182 ("A board may have regard for various constituencies in discharging its responsibilities, provided there are rationally related benefits accruing to the stockholders.")

144. *See* RICHARD POSNER, THE ECONOMIC ANALYSIS OF LAW 3-10 (1976).

145. *See* Jon Hanson and David Yosifon, *The Situational Character: A Critical Realist Analysis of the Human Animal*, 93 GEO. L. REV. 1 (2007).

146. *See* Armen A. Alchian, *Uncertainty, Evolution, and Economic Theory*, 58 J. OF POL. ECON. 211, 211 (1950) ("[W]here foresight is uncertain, 'profit maximization' is *meaningless* as a guide to specific action.") (emphasis in original).

for themselves the goal of, as the neologism has it, "satisficing" welfare rather than "maximizing" it.[147] That is, boundedly rational actors will aim at a "satisfactory" welfare achievement instead of the best possible outcome. This is a wise course of action for a boundedly rational actor. In this light, it makes little sense to charge a human agent with "maximizing" returns for her principal unless one implicitly understands that a human so charged will rationally endeavor to "satisfice" rather than "maximize" returns. Indeed, the human agent who would pursue only "maximization" would end up foolishly wasting all of her principal's resources in the failed effort to do it. Another way of putting this is that given our limited cognitive resources, "satisficing" is a "doing the best we can" strategy, and thus *is* a "maximization" strategy. So when talking about real humans there is no important difference between an agent who endeavors to maximize welfare and one who is merely trying to satisfice welfare. Thus the faithful Delaware board is perfectly prudent to pursue on behalf of its shareholders a satisfactory level of returns, a modest level of returns, or a consistent level of returns, rather than seeking in any strict sense to "maximize" returns.[148] The level of returns that directors pursue, like everything else, is left to their sound discretion.

What Delaware directors may not do is "satisfice" or "merely" satisfy the interests of shareholders in order to have cognitive capacity, time, or corporate wealth left over to serve the interests of non-shareholders. Consideration of non-shareholder interests is only permitted to the extent that such consideration is "rationally related" to shareholder interests.[149] Suppose, in stylized fashion, that directors were confronted with a decision to set the price for a particular product. The directors believe in good faith that they can set the price at $100 and produce a yearly profit of $10 per share. They also believe that they could instead set the price somewhat lower and produce a yearly profit of $8 per share, with the extra $2 staying in the consumer's pocket, to be put to other uses, like buying a donut or some life-saving medicine. Setting the price to pro-

147. The term "satisficing" was coined by Henry Simon, one of the founders of behavioral law and economics. *See* HENRY SIMON, MODELS OF MAN: SOCIAL AND RATIONAL (1957).

148. *See* Alchian, *supra* note 146, at 212 ("Under uncertainty, by definition, each action that may be chosen is identified with a distribution of potential outcomes, not with a unique outcome. . . . [L]et each of two possible choices be characterized by its subjective distribution of potential outcomes. Suppose one has the higher 'mean' but a larger spread, so that it might result in larger profits or losses, and the other has a smaller 'mean' and a smaller spread. Which one is the maximum? This is a nonsensical question.").

149. Revlon, 506 A.2d at 162.

duce the $8 profit might superficially be said to advance consumer interests in a way that is "rationally related" to advancing shareholder interests, since shareholders will make some profit out of the decision. But the directors here have to choose between setting the price to make $10 or $8 profit. They have both contingencies in mind, and must make a good faith choice between them. The decision to choose $8 profit instead of $10 profit is not "rationally related" to the shareholder interest. It advances the consumer interest at the expense of shareholders, and is thus forbidden.[150] (Directors obviously may choose to make $8 now instead of $10 now if they believe it will establish better relationships with consumers and result in more profits in the long-run, but that is a different issue.) Of course, directors do not ordinarily set prices for goods, they decide questions and set policy at a higher level of generality. The level of generality at which they choose to make decisions is entirely within their discretion, so long as that level is chosen with an eye towards serving shareholders, and not any other constituency.

Elhauge puts his own stylized version of this question thusly: "[c]an management of a timber corporation decline to clear-cut its timberland even though that sacrifices profits?"[151] Of course they can if it means higher future profits, "[b]ut suppose, in an incautious moment, management admits that the present value of those future profits from not clear-cutting [that stem from non-shareholder goodwill] cannot hope to match the large current profits that clear-cutting would produce."[152] Delaware corporate law does not countenance the profit sacrifice under this scenario. And certainly, as I explore in the next subsection, a director would violate Delaware law if ever she held secret in her mind an idea about what was good for shareholders out of fear that its expression might be "incautious" for other corporate stakeholders.

### *E. The Fallacy of Normative Indifference in the Business Judgment Rule*

A final interpretive move that has bred confusion on the law of corporate purpose is conflation of what the law requires with speculation about what directors can get away with. Some scholars claim that corporate boards can easily attend to non-shareholders at the expense of shareholders without getting

150. *Cf.* City Capital Assocs. Ltd. v. Interco, Inc., 551 A.2d 787, 802 (Del. Ch. 1988) ("*Revlon* dealt factually with an ongoing bidding contest for corporate control. In that context, its holding that the board could not prefer one bidder to another but was required to permit the auction to proceed to its highest price unimpeded, can be seen as *an application of traditional Delaware l*aw: a fiduciary cannot sell for less when more is available on similar terms.").

151. Elhauge, *supra* note 74, at 735-36.

152. Elhauge, *supra* note 74, at 735-36.

caught or punished. While this may be true in some contexts, sometimes getting away with something to some extent is by no means the same thing as being always authorized to do it. This distinction is too often obscured, or ignored, in positive analysis of the law of corporate purpose.

The source of this *de facto* and *de jure* obfuscation is found in a slippery interpretation of one of corporate law's most potent doctrines, the "business judgment rule." This is a rule of judicial design which holds that courts will not impose personal liability against a director for a corporate decision so long as the director was personally disinterested in the decision (i.e., had no conflict of interest), the decision was informed, deliberate and made in good faith, and the decision was legal.[153] If these simple conditions are met, directors will be insulated from personal liability for bad, strange, negligent, or even disastrous business decisions.[154] A shareholder whose only complaint is that directors are pursuing the wrong business plan is bounced right out of Chancery.[155]

Because of the business judgment rule, directors have near total discretion to run firms the way they see fit. It is true, therefore, that it is nearly impossible to enforce the shareholder primacy norm through litigation, absent, essentially, an explicit statement by directors that they are managing the firm towards some other goal. Absent, that is, a confession that negates the presumption of good faith that the business judgment rule supplies. But just because shareholder primacy cannot be easily enforced through lawsuits does not alter the fact that it is the prevailing law of corporate governance in Delaware. In *The Shareholder Value Myth*, Lynn Stout blithely collapses these distinctions when she

153. *See* JAMES D. COX & THOMAS L. HAZEN, BUSINESS ORGANIZATIONS LAW 197-216 (2011) (discussing business judgment rule).

154. *Id*.

155. Several justifications are given for the business judgment rule. Most simply it is seen as giving force to the statutory injunction that "the business and affairs of every corporation . . . shall be managed by or under the direction of a board of directors." DEL. GEN. CORP. L. § 141(a). Since somebody has to have the last word on what corporate decisions are legitimate, the business judgment rule sees to it that, per the statute, it is the directors who decide, not complaining shareholders, not other stakeholders, and not indifferent courts. Directors are likely to know more about the particulars of problems their firms face than are relatively ignorant shareholders, stakeholders, and judges. The business judgment rule also coheres with modern portfolio theory, which assumes that most shareholders invest their assets in highly diversified fashion and therefore prefer individual firms to be risk-preferring. Shareholders enjoy unlimited upside with highly profitable firms, but can only lose the amount of their investment in firms that fail. Therefore the gains from a few highly successful investments can easily offset the losses from several failures. The business judgment rule helps support this risk-preferring strategy in individual companies, as it absolves corporate boards from fear that aggressive, unorthodox decision-making will be second-guessed if it goes wrong.

writes: "The notion that corporate law requires directors . . . to maximize shareholder wealth simply isn't true. There is no solid legal support for the claim that directors . . . in U.S. corporations have an enforceable legal duty to maximize shareholder wealth. The idea is a fable."[156] There is indeed little precedent showing courts enforcing the shareholder primacy norm, but the paucity of such actions stands beside a jurisprudence that very clearly specifies that Delaware's law requires shareholder primacy in firm governance. Of course, it really is a fable to say that the enforceable duty is a fable, instead of more accurately saying that enforcement is rare, since *Revlon* and *eBay* and are both cases where Delaware does enforce the shareholder primacy obligation.[157]

This is a recurring problem in the literature. Christopher Bruner, after first promising that his article, *The Enduring Ambivalence of Corporate Law*,[158] would "describe . . . explicit deviations from shareholder wealth maximization" as being "common both in takeover law and with respect to charitable donations,"[159] finally acknowledges (in his footnotes) that he can draw only a "de facto"[160] conclusion about the current state of these things in Delaware. I emphasize here with italics the word that Bruner slips into a parenthetical: "the board enjoys . . . considerable latitude to deviate (*tacitly*) from shareholder wealth maximization."[161] The enduring ambivalence that Bruner purports to describe is therefore not a statement about Delaware law, but about what lawless directors might get away with.[162]

With no good cases to substantiate his claim that Delaware disavows shareholder primacy, Einer Elhauge is in the end similarly left with nothing but what we might pedantically call the fallacy of normative indeterminacy in the business judgment rule. Elhauge argues that where non-shareholder interests are threatened in a takeover bid, "[m]anagement need only, if it wants to do so, make sure that the winning bid is structured to include some securities whose future value *can be claimed* to bear some rational relationship to effects on oth-

156. STOUT, *supra* note 3 at 25.

157. Stout later claims that *Revlon* is an "exception that proves the rule," and so is apparently for her not fable-busting. *See supra* Section IV(A) (critiquing Stout's view of *Revlon*).

158. Christopher M. Bruner, *The Enduring Ambivalence of Corporate Law*, 59 ALA. L. REV. 1385 (2008).

159. *Id.* at 1401.

160. *Id.* at 1400 n. 84.

161. *Id.* at 1412.

162. *Id.* at 1400 n. 84.

er constituencies."[163] Andrew Gold similarly misinterprets the business judgment rule as reflecting ambiguity about the law of corporate purpose:

> The business judgment rule is often viewed as a response to judicial uncertainty regarding the appropriate means to corporate ends. . . . The business judgment rule, however, can also be viewed as a response to judicial uncertainty as to the appropriate *ends* of director decisions.[164]

But where is the evidence for this judicial uncertainty? It is not found in law, but in presumptions about business practice that deviates from what the law commands: "The business judgment rule, combined with recognition that boards may consider long-term shareholder interest, makes it quite easy for the board to ignore shareholder wealth maximization."[165]

In his essay describing ambivalence on the question of corporate purpose in Delaware, David Millon similarly argues that Delaware's rule that nonshareholder interests have to be rationally related to shareholder value is "of no practical importance, because shareholders lack the ability to challenge management policies that favor nonshareholder interests even if the result is reduction of profits."[166]

The issue that I am trying to specify is not what directors might get away with in the courtroom but what the law calls on directors to think and do in the boardroom. *Revlon* and *eBay* tell us that directors' decisions must truly, actually, sincerely, be made in the best interests of the shareholders. Since directors are fiduciaries of the corporation and its shareholders, directors have an obligation to speak truthfully to shareholders about what they are doing with the firm. To behave in good faith, as the law requires them to do, directors must say what they believe and believe what they say. Directors, as fiduciaries, cannot lie about what they are doing and why they are doing it.

We must, therefore, in our positive analysis, distinguish between plausible assertions, duties easily ignored, and tacit undertakings, which faithless serv-

163. Elhauge, *supra* note 74, at 852. He further claims that "management may not even need to do that if the difference in price is less than one percent." *Id.* I disproved this assertion, *supra* text accompanying notes 93-104.

164. *See* Gold, *supra* note 108, at 1095.

165. *Id.* at 1099. Gold inexplicably relegates *eBay* to a terse footnote, and gives it no extended discussion. *See id.* at 1093 n. 20.

166. Millon, *supra* note 105, at 527.

ants may abide, and sincere, good faith deliberation and decision-making, which honest men and women will strive for when they are true to their duty. In this vein, Delaware's pronouncements about directors' obligations running solely to shareholders are most certainly of practical importance. Delaware does not countenance directors secretly serving non-shareholders at the expense of shareholders, and progressive corporate law should not wed itself to or promote such duplicity. Within a corporate governance system that explicitly avows process, loyalty, credibility, and deliberation as its essential and most valued qualities, it is wholly inapposite to conclude that anything "tacit" should play a crucial role in an accurate or desirable conception of proper corporate governance.

## V. THE COSTS OF CONFUSION

### *A. Critique of the Shareholder Primacy Norm*

Shareholder primacy is undoubtedly the law of Delaware, the most important corporate law jurisdiction in the known universe. But I do not believe this rule is desirable. The shareholder primacy norm is responsible for substantial suffering and political dysfunction in our society.[167] The justifications that its supporters offer on its behalf are implausible.[168]

The contemporary normative defense of shareholder primacy is as follows. The law prescribes shareholder primacy as the default rule of corporate governance because it is the rule that all corporate stakeholders, including non-shareholders, would agree to it if they actually sat down and negotiated the terms of their collective dealings. Since in the context of large corporations it is impossible for all corporate stakeholders to gather and dicker over terms, the law prescribes default rules that it believes makes all parties better off than they otherwise would be, thus cloaking the default rule of shareholder primacy in both sacred vestments: efficiency and voluntarism.

Shareholders must be given fiduciary-level attention in firm governance in

167. For the short-version justification of this claim, I cite to no less an authority than the Chancellor of the Delaware Court of Chancery, *see supra* note 48 (acknowledging, indeed, asserting as obvious, that the profit-making orientation of corporate law leads, if unchecked, to predictably anti-social outcomes like, for example, the financial crisis, environmental contamination, and bad milk). For the longer-version justification of this claim, *see* David G. Yosifon, *The Consumer Interest in Corporate Law*, 43 U.C. DAVIS L. REV. 253 (2009)

168. I have explored this argument in detail in previous work and provide only a short summary here. *See* Yosifon, *supra* note 167, and David G. Yosifon, *The Public Choice Problem in Corporate Law: Corporate Social Responsibility After* Citizens United, 89 N. C. L. REV. 1197 (2011).

order to induce them to invest capital in a corporation they will not control, and from which they will not benefit unless the firm is profitable and pays dividends. Since shareholders feed on profits only *after* products have been delivered to consumers, wages paid to workers, and taxes rendered to the state, non-shareholder interests are *necessarily* satisfied in the course of the directors' struggle to benefit shareholders. Moreover, whereas shareholders are absent from firm operations, workers are present on the shop-floor and can manage or negotiate the terms of their association with the firm directly, or through unions. Consumers are similarly present and can manage their interests in firm associations at the cash register, by taking or leaving offers of sale.[169] Shareholders would therefore bargain for the corporate arrangement to include an exclusive attention to their interests by the board of directors, and other stakeholders would be happy to (are happy to) settle for that arrangement.

This is an elegant formulation. But it starts to break down when it is seen that once directors are charged with managing firms in the shareholder interest, the directors will be motivated to overreach in their dealings with non-shareholders in order to better serve shareholders. Workers are watching, but it is difficult for them to see some kinds of corner-cutting on safety in the workplace, such as asbestos in the walls or repetitive stress injuries in the keyboards. Consumers are on guard, but they cannot easily see or understand the risk factors of many products, such as ammonia in cigarettes or trans-fats in French fries. The seriousness of this problem grows in light of social scientific research revealing that human perceptions of many things, and risk in particular, are far more vulnerable to influence and manipulation (through marketing efforts, for example) than our intuitions would otherwise lead us to believe.[170] The standard defense of shareholder primacy is informed by common sense views about human decision-making and behavior, but this common sense has been brought into doubt by social science. Firms pursue shareholder interests not always by serving workers and consumers, but also by exploiting them.

Even if this overreach problem is true, mainstream corporate theorists insist that it would be destructive to give up the clarity and efficiency of shareholder

169. *See generally* Yosifon, *supra* note 167 (elaborating this argument).

170. *See* Hanson & Yosifon, *supra* note 145 (surveying social scientific research which casts doubt on the plausibility and utility of rational actor and other intuitive models of human behavior in legal analysis); *see also* DANIEL KAHNEMAN, THINKING: FAST AND SLOW (2011) (summarizing his own Nobel Prize winning work, and other research, describing the complex and often counter-intuitive nature of human decision making).

primacy in corporate governance. Instead, corporate directors should be required to pursue shareholder interests within a regulatory regime that forbids exploitative conduct. Instead of non-shareholders receiving attention at the level of firm governance, they should be protected from shareholder primacy's overreach through employment law, consumer protection statutes, environmental regulations, and the like. However, this is an unsatisfactory response, given that directors charged with pursuing profits for shareholders will recognize that such external regulations threaten to stand in the way of corporate profitability. Firms will ineluctably dedicate themselves to destroying or mitigating the impact of such regulations. They will pursue this through the normal sausage-making means of lobbying and supporting political candidates sympathetic to their interests, and through more elaborate efforts to influence public perception of what counts as sound public policy. Corporations with narrow interests and access to persuasive agents (like lawyers) will tend to enjoy an advantage in the competition for regulatory favor over widely dispersed, structurally impotent non-shareholders. Shareholder primacy in practice gives rise to a public choice problem that renders shareholder primacy unjustifiable in theory.

When advocates of shareholder primacy address this public choice critique of their favored form of corporate governance, they have traditionally tried for one final retreat to the claim that we should forbid corporations from participating in the political process, thus leaving the corporation to act unfettered in the shareholder interest, within government strictures legitimately arrived at. But in *Citizens United v. Federal Elections Commission* (2010) the Supreme Court of the United States made clear that the First Amendment forbids Congress from restricting the political activity of corporations.[171] As long as *Citizens United* is good constitutional law, shareholder primacy is bad corporate theory.

### *B. Towards Honest Multi-Stakeholder Corporate Governance*

Given the failure of shareholder primacy theory and the myriad evidence of individual, social, and environmental harm caused by firms operating under the shareholder primacy norm,[172] we must seek corporate law reforms which encourage good faith attention to the interests of multiple corporate stakeholders at the level of firm governance. Here I re-join my fellow "progressive" corporate law scholars who argue normatively for a departure from shareholder pri-

171. 558 U.S. 50 (2010); *see also* Yosifon, *The Public Choice Problem in Corporate Law*, *supra* note 168 (analyzing corporate law implications of *Citizens United*).

172. *See* Strine, *supra* note 49 (summarizing social and environmental harms caused by corporate operations).

macy.

Even if the business judgment rule, as it functions in Delaware today, provides directors with sufficient flexibility to get away with some amount of attention to non-shareholder interests, the current regime does not require—indeed, would not permit—the kind of open, fulsome discourse in the board room that we recognize as essential to any really good institutional decision-making. Any attention that is given to non-shareholders presently has to be done surreptitiously, in hushed tones, through lies. This is not sustainable, and it is not desirable. To govern effectively a corporate board must govern openly and honestly. Individual directors must be true to themselves and they must be true with each other. So long as attention to non-shareholder concerns that are not really related to shareholder interests remains tacit, forbidden from actually being spoken, corporate decisions will be confused, incoherent, and potentially destructive. "Don't ask, don't tell," was a dishonorable, institutionally dysfunctional way of allowing gay people to serve in the armed forces while formal law forbade their presence in the service. "Don't ask, don't tell" is a similarly dishonorable and institutionally dysfunctional way to bring non-shareholder interests into the boardroom, where formal law forbids their presence.

In other work, I have explored some ways in which a multiple-stakeholder corporate governance regime could be implemented.[173] I have examined what I call "prescriptive discourse norms" as a mechanism through which expanded obligations of corporate directors could be actualized.[174] "Discourse norms" comprise a key contract term in the firm's relationship with its various stakeholders. The discourse norm in the shareholder's contract presently calls for directors to speak about and to shareholders with the highest level of clarity and truth: "not honesty alone, but the punctilio of an honor the most sensitive."[175] Presently a looser, less demanding discourse norm is embedded by default into a corporation's contracts with its workers and consumers. The reform that I imagine would require directors to serve multiple stakeholders as fiduciaries. They would be told to accomplish this charge by undertaking the same process

173. *See* David G. Yosifon, *Discourse Norms as Default Rules: Structuring Corporate Speech to Multiple Stakeholders*, 21 HEALTH MATRIX 189 (2011)*; see also* David G. Yosifon, *Consumer Lock-In and the Theory of the Firm*, 35 SEATTLE U. L. REV. 1429 (2012) and David G. Yosifon, *Towards a Firm Based Theory of Consumption*, 46 WAKE FOREST L. REV. 447 (2011).

174. *See* Yosifon, *Discourse Norms as Default Rules*, *supra* note 173.

175. Meinhard v. Salmon, 164 N.E. 545 (N.Y. 1928) (Cardozo, J) (defining the standard of conduct expected of a fiduciary).

obligations that presently describes the directorial duty to shareholders. Directors would be required to become informed about and actively deliberate in open, honest, and good faith fashion, about how proposed corporate conduct would advance or undermine the interests of workers, consumers, and other stakeholders, not just shareholders. Where the interests of one stakeholder group are truly in tension with another, directors would be forced to exercise their sound discretion and balance competing claims, just as the law presently requires them to do when balancing the interests of short-term speculators and long-term investors, of diversified and undiversified investors, of old and young investors.[176]

As Chancellor Strine recognized, for-profit corporate boards can usually be counted on to follow their structural motives and legal obligation to serve shareholder interests. Sometimes they will do this by serving non-shareholder interests, but they will also do this, when they can, by exploiting non-shareholder interests. Chancellor Strine and other shareholder primacy advocates are mistaken, however, when they argue that this impulse can be restrained through external government regulation of corporations without altering the structure or law of corporate governance. Public choice dynamics, and constitutional limitations, make such exclusively external remedies implausible. Neither is it plausible to encourage directors to exercise present authority to pay greater attention to non-shareholder interests, for that authority is not there, not in Delaware anyway. Instead, we must have fundamental reform of corporate governance law that requires directors to actively attend to the interests of multiple stakeholders at the level of firm governance, openly, honestly, and in good faith.

176. *See supra* notes 80-81 and accompanying text (discussing the Delaware Supreme Court's specification in *Unocal* that there is no "controlling" authority in Delaware jurisprudence dictating how tensions between the interests of short-term and long-term shareholders are to be resolved and indicating instead that management of such tensions falls to the sound discretion of the corporation's directors).