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## Freedom of Corporate Purpose

George A. Mocsary

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# Freedom of Corporate Purpose

*George A. Mocsary\**

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## INTRODUCTION

Every few decades, there erupt political and academic debates over the proper nature and purpose of the corporation.<sup>1</sup> It is black letter law, according to most scholars, that corporations exist to maximize shareholder wealth. Others maintain that the corporation should exist for the benefit of multiple constituencies, regardless of what current black letter law may say. The current discourse of corporate purpose, however, is incomplete and misleading. The disarray has resulted from insufficient reliance on historical context in (1) analyzing the firm under modern theories of corporate governance, and (2) interpreting the “purpose” language in corporate charters and corporation-law statutes.

Modern conceptions of corporate governance, and by extension, corporate purpose, have failed to account for the historical evolution of the firm. Significantly, they characterize the corporation along too few dimensions, typically treating the firm as merely, and exclusively, a contract- or property-based entity; and they neglect to treat the later-stage corporation as a historical entity that inherits characteristics and restrictions, including its purpose, from the time of its founding.

Corporations are a triality of property, contractual, and associational rights. Firms can simultaneously and independently be described along each dimension. The triality of rights should entitle shareholders to form general corporations to pursue the ends of their choosing—shareholder wealth maximization or otherwise. Focusing on one aspect of the firm at the expense of the other two, however, obscures the central place of shareholder ends in the corporation.

At its inception, the corporation is nearly indistinguishable from its shareholders, who possess the special talents or resources around

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1. *E.g.*, LYNN STOUT, *THE SHAREHOLDER VALUE MYTH: HOW PUTTING SHAREHOLDERS FIRST HARMS INVESTORS, CORPORATIONS, AND THE PUBLIC* (2012); Stephen M. Bainbridge, *In Defense of the Shareholder Wealth Maximization Norm: A Reply to Professor Green*, 50 WASH. & LEE L. REV. 1423, 1435 n.40 (1994) [hereinafter Bainbridge, *SWM Norm*]; Stephen M. Bainbridge, *Interpreting Nonshareholder Constituency Statutes*, 19 PEPP. L. REV. 971, 971 (1992) [hereinafter Bainbridge, *Constituency Statutes*]; Lawrence E. Mitchell, *A Theoretical and Practical Framework for Enforcing Corporate Constituency Statutes*, 70 TEX. L. REV. 579, 583 n.17 (1992) (citing waves of sources engaging the topic about every 20 years).

which the enterprise is started. They possess all the property, financial, and control sticks in the corporate bundle of rights. They associate via the corporate form to better achieve some end than they could without it. Shareholders necessarily give up ever more control as the firm grows. But even at later stages in a firm's life, shareholders retain enough rights to entitle them to have their corporations run in pursuit of the purposes they established at the firm's founding (or later modified via the proper procedures).

This Article distinguishes two understandings of the corporate "purpose" language that is a statutorily required component of every corporate charter. The first is what the Article terms the corporation's "tactical," or operating, purpose. A corporation engages in its operations as it pursues its "strategic" purpose. The strategic purpose is the telos of the corporation or its board of directors. Shareholder wealth maximization is the archetypical strategic purpose, and the one most naturally derived from the corporate bundle of rights.

The Article addresses the assertion that corporate law does not, at least by default, require directors to maximize shareholder wealth, and concludes that this claim is indefensible when viewed in proper context. This fundamental stockholder right established, the Article proposes expanding existing law to allow stockholders to charter corporations for any lawful strategic purpose, given sufficient notice to potential mid-stream shareholders. It thus argues for a clarification of the marked uncertainty in corporate law as to whether nonwealth corporate ends are cognizable. Corporate law provides the pieces to maximize the social benefit enabled by the corporate form. This Article offers a flexible yet simple way to join those pieces together by permitting, but not requiring, stockholders to depart from the wealth maximization norm.

This Article proceeds in three parts. Part I situates the discussion of purpose amidst the three primary theories of corporate governance, lays out the Article's working model of the corporate bundle of sticks, and sets forth its definition of corporate purpose. Part II interrogates the five primary arguments against the shareholder wealth maximization norm. Part III proposes that shareholders be allowed to depart from the norm by forming corporations to pursue their choice of strategic purposes. It also addresses accountability concerns raised by the proposal.

## I. CORPORATE GOVERNANCE AND CORPORATE PURPOSE

This Part begins by reviewing the history and features of the three ascendant models of corporate governance. It draws on this discourse to make observations about the characteristics of corporations and shareholders, the relationships between the two, and the nature of corporate ends. It then discusses states' reasons for chartering corporations. It thus lays out the analytical framework for the remainder of the Article.

### *A. Corporate Governance Frameworks*

The major milestones in corporate theory over the last quarter millennium situate the three dominant models of corporate governance: shareholder primacy, director primacy, and the team-production model.

In his renowned 1776 treatise *The Wealth of Nations*, Adam Smith presented the classical view of the corporation owned by its shareholders and managed on their behalf:

The directors of [corporations], . . . being the managers rather of other people's money than of their own, it cannot well be expected, that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own. Like the stewards of a rich man, they are apt to consider attention to small matters as not for their master's honour, and very easily give themselves a dispensation from having it.<sup>2</sup>

Professors Adolf A. Berle, Jr. and Gardiner C. Means echoed this conception of the firm 157 years later in their famous *The Modern Corporation and Private Property*. They focused on the “separation of ownership and control” in diffusely held firms like public corporations in which traditional incidents of ownership were no longer vested in an individual or a small group with detailed knowledge of the firm's business.<sup>3</sup> The separation made shareholder-owners even more vulnerable to managerial self-dealing than they were in Adam Smith's time.

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2. 2 ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS 233 (Edwin Cannan ed., Methuen & Co. 1904) (1776); *see id.* at 232–48.

3. ADOLF A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 4–6, 70–72, 89–93 (1933).

Economist Milton Friedman summarized the view that managers worked for stockholders in 1970:

In a free enterprise, private-property system, a corporate executive is an employee of the owners of the business. He has [a] direct responsibility to his employers. That responsibility is to conduct the business in accordance with their desires, which *generally* will be to make as much money as possible while conforming to the basic rules of the society . . . . Insofar as his actions in accord with his “social responsibility” reduce returns to stockholders, he is spending their money.<sup>4</sup>

Although Professor Friedman is frequently quoted for his support of shareholder wealth maximization, his careful use of the word “generally” suggests that, although it may not be commonplace, he apparently believed that shareholder ends need not be monetary.

Six years later, Professors Michael C. Jensen and William H. Meckling solidified the agency theory of the firm, under which managers work to generate profits for their shareholder principals.<sup>5</sup> They also popularized the nexus-of-contracts view, which characterizes corporations as “*legal fictions which serve as a nexus for a set of contracting relationships among individuals.*”<sup>6</sup> Although agency theory strongly implies firm ownership by the principals, and Jensen and Meckling referred to shareholders as “owners,”<sup>7</sup> their analysis also suggests that shareholders are merely providers of one of the inputs—capital—needed to run the firm.<sup>8</sup>

In 1991, Professors Frank H. Easterbrook and Daniel R. Fischel wholeheartedly adopted the contractarian view of the firm in their influential *The Economic Structure of Corporate Law*.<sup>9</sup> They abandoned

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4. Milton Friedman & Craig P. Dunn, *The Social Responsibility of Business Is to Increase Its Profits*, N.Y. TIMES MAG., Sept. 13, 1970, § 6, at 32, 33 (emphasis added).

5. Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 308–09 (1976).

6. *Id.* at 310–11. Professors Jensen and Meckling found roots for their work in that of Arman Alchian and Harold Demsetz on corporations and property rights. *Id.* at 307 & n.5. Professors Alchian and Demsetz referred to the firm as a “*centralized contractual agent in a team productive process.*” Armen Alchian & Harold Demsetz, *Production, Information Costs, and Economic Organization*, 62 AM. ECON. REV. 777, 777–78 (1972).

7. Jensen & Meckling, *supra* note 5, at 308–09, 317–19.

8. *See id.* at 311.

9. FRANK H. EASTERBROOK & DANIEL R. FISCHEL, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 1–39, 91 (1991).

the notion that shareholders own the firm, but nevertheless continued to assert that managers were shareholders' agents.<sup>10</sup>

Shareholder Primacy and Director Primacy stem from, and Team Production responds to,<sup>11</sup> these frameworks. Each contains both descriptive and normative elements. Director Primacy and Team Production proponents acknowledge that their frameworks are less descriptive in the context of a controlling shareholder.<sup>12</sup> Some of the models' features nevertheless depend on assumptions related to the firm's founding. Those features are addressed in this and the next section.

### 1. *Shareholder primacy*

Shareholder primacy is based primarily on the view that shareholders own the corporation. But, in some iterations, it takes on contractarian attributes.

Classic shareholder primacy holds that corporate managers<sup>13</sup> work for shareholder-owners.<sup>14</sup> The shareholders, who risked their wealth to enable the enterprise, are entitled to have the firm run for their benefit and have a "residual" claim on anything left over after the firm's contractual obligations have been fulfilled.<sup>15</sup> Managers have incentive to shirk because they do not receive all of the marginal

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10. *Id. passim*; Frank H. Easterbrook & Daniel R. Fischel, *Voting in Corporate Law*, 26 J.L. & ECON. 395, 396 (1983) ("Shareholders are no more the 'owners' of the firm than are bondholders, other creditors, and employees (including managers) who devote specialized resources to the enterprise . . .").

11. Professors Blair and Stout also found roots for their Team Production model in economists Armen Alchian's and Harold Demsetz's work on coordination in complex productive processes. Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 265–68 (1999); *see supra* note 6.

12. Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 596–97 (2003); Blair & Stout, *supra* note 11, at 256, 281, 309.

13. This Article's references to managers includes directors unless stated otherwise.

14. *E.g.*, BERLE & MEANS, *supra* note 3, *passim*; Bernard S. Sharfman, *Shareholder Wealth Maximization and Its Implementation Under Corporate Law*, 66 FLA. L. REV. 389, 396–97 (2014); *see supra* text accompanying notes 3–8; *infra* Section II.A.1.

15. BERLE & MEANS, *supra* note 3, *passim*; Jensen & Meckling, *supra* note 5, at 311–12; *cf.* Simons v. Cogan, 542 A.2d 785, 791 (Del. Ch. 1987) (contrasting the contractual rights of bondholders and fiduciary duties owed to shareholders to protect their interests); Harff v. Kerkorian, 324 A.2d 215, 218–19 (Del. Ch. 1974) (stating that stock ownership is evidence of the ownership of corporate assets rather than a debt owed by the corporation).

benefits of their work, as a 100-percent owner-manager would.<sup>16</sup> Being self-interested, they will attempt to run firms to maximize their own well-being rather than that of their shareholder principals.<sup>17</sup> This incentive misalignment causes the firm to be run inefficiently—in a way that creates less overall value—with the resulting loss of value termed “agency costs.”<sup>18</sup> To minimize agency costs, managers are legally required to exert their best efforts to maximize shareholder wealth.<sup>19</sup> With this corporate goal fixed, nonshareholder constituencies—managers, employees, customers, creditors, communities, and others—can contract ex ante for their fair share of the value created by the corporation.<sup>20</sup>

In its contractarian iteration, shareholder primacy views the corporation as a contract-facilitation entity that serves as a natural nexus for production factors. In its most property-oriented form, shareholders still own the company, but they do business in the corporate form because it catalyzes the contracting with managers, employees, and others that is needed for production.<sup>21</sup> Importantly, it allows contracts that would have to be negotiated individually across markets to be brought into the firm and directed in a command-and-control fashion.<sup>22</sup> At its other extreme, shareholder primacy eschews the notion of the corporation as a thing capable of being owned. Under this version, shareholders merely provide capital to the corporation in exchange for a residual claim on its assets.<sup>23</sup>

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16. Jensen & Meckling, *supra* note 5, at 312–13.

17. Lucian Bebchuck, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 850 (2005); Jensen & Meckling, *supra* note 5, at 308.

18. Jensen & Meckling, *supra* note 5, at 308–10.

19. Other ways to reduce agency costs include setting up performance monitoring and evaluation systems, compensation schemes, and internal rules to minimize managerial self-dealing. Jensen & Meckling, *supra* note 5, at 308–09, 328.

20. Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L. REV. 439, 441 (2001).

21. See *supra* notes 8–9 and accompanying text. Professors Margaret M. Blair and Lynn A. Stout employ the catalysis portion of this contractarianism in their Team Production model. See *supra* note 11; *infra* Section I.A.3.

22. Ronald H. Coase, *The Nature of the Firm*, ECONOMICA, Nov. 1937, at 386, 390–98. The need for these contracts may be anticipated or unanticipated.

23. See Sharfman, *supra* note 14, at 397; Alexei M. Marcoux, *For Shareholder Wealth Maximization, Against Corporate Purpose*, LIBR. L. & LIBERTY (Dec. 5, 2013), <http://www.libertylawsite.org/liberty-forum/for-shareholder-wealth-maximization-against-corporate-purpose>; *supra* notes 7–9 and accompanying text. Professor Stephen M. Bainbridge



## 2. *Director primacy*

Professor Stephen M. Bainbridge's Director Primacy framework is purely contractarian, viewing firms as incapable of either being owned or having a defined purpose.<sup>24</sup> Shareholders supply capital in an implicit exchange for the residual claim on the firm's assets.<sup>25</sup> Director primacy sees the board of directors, rather than the firm or its stockholders, as the *sui generis* nexus of contracts that hires production factors.<sup>26</sup> The board is not an agent of the shareholders, but the supreme power in a web of contractual relationships that includes it.<sup>27</sup> The board is therefore most like the firm's "owner."<sup>28</sup>

Director Primacy's key objection to classical Shareholder Primacy's view of shareholders as owners is that shareholders do not exhibit many of the usual characteristics of owners, most notably control over the corporation's assets or activities.<sup>29</sup> Professor Bainbridge is known for saying that "the board acts and the shareholders, at most, react" to the board's actions.<sup>30</sup> Strong central decision-making authority in the board is necessary, however, to run the corporation (or, at least public ones) effectively.<sup>31</sup> Yet because the board can abuse its power to its members' advantage, it is legally obliged via fiduciary duties to maximize the wealth of the shareholder residual claimants.<sup>32</sup>

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employs this form of contractarianism in his Director Primacy model. *See supra* note 12; *infra* Section I.A.2.

24. Stephen M. Bainbridge, *The vacuity of corporate purpose*, PROFESSORBAINBRIDGE.COM (May 5, 2012), <http://www.professorbainbridge.com/professorbainbridge.com/2012/05/the-vacuity-of-corporate-purpose.html>; *see also* WILLIAM A. KLEIN ET AL., BUSINESS ORGANIZATION AND FINANCE 117–22 (11th ed. 2010) (acknowledging that the law treats corporations as real entities, but arguing that this approach is improper as a matter of theory because firms are human instrumentalities).

25. Bainbridge, *supra* note 12, at 563.

26. *Id.* at 550, 559–60.

27. Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 VAND. L. REV. 83, 102 (2004).

28. *Id.* at 102–03.

29. Bainbridge, *supra* note 12, at 563–74.

30. *Id.* at 559; *see id.* at 563, 570.

31. Bainbridge, *supra* note 27, at 86, 103; *see supra* note 12 and accompanying text.

32. Bainbridge, *supra* note 27, at 103; Bainbridge, *supra* note 12, at 563–65.

### 3. *Team production*

The Team Production model's distinguishing characteristic is that it disavows the notion that board members are shareholders' agents who have a duty to maximize shareholder wealth.<sup>33</sup> Rather, the board's role is to act as a group of "mediating hierarch[s]" that "protect[s] the enterprise-specific investments of . . . the corporate 'team,' including shareholders, managers, rank and file employees, and possibly other groups, such as creditors" and "the local community."<sup>34</sup>

Team members hire the board to protect them from each other's opportunism and to coordinate their production activities.<sup>35</sup> They thus opt into the hierarchy to mutually relinquish to the board of directors their rights over firm-specific inputs.<sup>36</sup> This mutual hands-tying makes it safe for team members to make long-term investments which are difficult to protect via explicit contract, but are essential for the firm to operate efficiently and profitably.<sup>37</sup> Free of responsibility to any one group, directors are able to serve the entire team.<sup>38</sup>

The Team Production model is contractarian, but "not so much a 'nexus of contracts' . . . as a 'nexus of firm-specific investments.'"<sup>39</sup> Like Director Primacy, it holds that shareholders do not own firms.<sup>40</sup> Rather, "[c]orporations [or at least public ones] are independent legal entities that own themselves."<sup>41</sup> Contrary to Director Primacy, the Team Production model posits that, although the corporation exists, shareholders (and presumably the other team members) are "fictional," at least from the standpoint of the corporate entity.<sup>42</sup>

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33. Blair & Stout, *supra* note 11, at 248–49.

34. *Id.* at 250, 253.

35. *Id.* at 280.

36. *Id.* at 274, 277.

37. *Id.* at 253, 275, 277, 285.

38. *Id.* at 288. Professors Blair and Stout find support for their view in the manager-friendly nature of the business judgment rule. *Id.* at 298–309.

39. *Id.* at 275, 285.

40. STOUT, *supra* note 1, at 8.

41. *Id.* at 37; *see supra* note 12 and accompanying text.

42. *Id.* at 59–60, 86–87, 89.

*B. The Property-Contract-Association Triality*<sup>43</sup>

Despite their differing theoretical underpinnings, each framework described in the previous section possesses varying descriptive strength depending on the firm's particulars and the situation in which it finds itself. This section begins by analyzing the shareholder's interest in the corporate bundle of sticks as the firm proceeds from its founding. It continues with a description of its approach to "corporate purpose." The section concludes with a note on the state's purpose in chartering corporations.

*1. The corporate bundle of sticks*

This section portrays a typical founding of a firm and its growth into a public corporation.<sup>44</sup> It traces the development of the corporate bundle of sticks,<sup>45</sup> tying in each corporate-governance model's characterization of the firm, to show that shareholders retain enough sticks to entitle them to corporate pursuit of their charter-specified ends.

*a. The early stages.* A new corporation enjoys a great deal of unity with its founder-owner. Once the charter<sup>46</sup> is in hand, the founder may cause the new firm to issue all its shares to him or her, or to multiple individuals. The new share owner or owners may put cash or property into the firm, or provide it only with services. In the case of a single

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43. This section is named after the Wave-Particle Duality of Light. After centuries of debate over whether light consisted of particles or waves, modern physics has confirmed that it can, independently and simultaneously, be characterized as both. *E.g.*, Kenneth R. Spring & Michael W. Davidson, *Light: Particle or a Wave?*, MOLECULAR EXPRESSIONS, <http://micro.magnet.fsu.edu/primer/lightandcolor/particleorwave.html> (last visited Sept. 8, 2016).

44. The real but stylized examples in this section are just a few of the near-infinite number of variations on a firm's life cycle. Hybrids of the stages described herein of course exist. This will not, however, typically change the analysis.

45. *See* Alchian & Demsetz, *supra* note 6, at 783 (referring to the corporate "bundle of rights").

46. Traditionally, the charter consisted of the articles of incorporation filed by the founder along with the certificate of incorporation issued by the state of incorporation. Delaware and the Model Business Corporation Act have eliminated this procedure, replacing it with one in which the articles are made official by a stamp indicating the time of filing. DEL. CODE ANN. tit. 8, § 103(c)(3) (Supp. 2014); MODEL BUS. CORP. ACT §§ 1.25, 2.03 & cmts. 1–3. Delaware has further complicated matters by referring to the articles as the certificate. DEL. CODE ANN. tit. 8, §§ 101–103 (2011 & Supp. 2014, 2015).

shareholder, the founder is likely to elect him- or herself the sole director. This “election” is likely to be a nonevent, with the owner simply proceeding to do business in the corporate name. If there are multiple original shareholders, the selection of directors may be more formal, but still consist of little more than a conversation or e-mail exchange among the founding team. The original group is almost certain to run the firm, hiring employees to do basic tasks as needed. The group’s members, who would be unlikely to entrust their financial futures to strangers, will be well acquainted. Professor Henry Mintzberg refers to this organizational form as the Simple Structure.<sup>47</sup>

A Simple Structure nearly indistinguishable from its owners is the incorporated family farm.<sup>48</sup> The family, which generally incorporates to receive limited-liability protection or realize tax benefits,<sup>49</sup> comprises the farm’s shareholders and runs the farm essentially as it would without the benefit of incorporation.<sup>50</sup> Its entire life, including its home, is the farm.

The law recognizes and embraces this unity. Subchapter S of Chapter 1 of the Internal Revenue Code provides perhaps the most ubiquitous example,<sup>51</sup> allowing a corporation’s shareholders to select “S corporation” status for the firm to cause it to be taxed on a pass-through basis.<sup>52</sup> The tax code effectively treats an act of the s-corp as an act of the shareholders—every dollar that the firm pays for, say, health insurance,<sup>53</sup> is one that is neither earned by nor attributed to the shareholders. Corporate law’s veil-piercing doctrines recognize

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47. HENRY MINTZBERG, *STRUCTURE IN FIVES: DESIGNING EFFECTIVE ORGANIZATIONS* 159 (1993); *see id.* at 157–61 (describing the Simple Structure).

48. *See* *Cargill, Inc. v. Hedge*, 375 N.W.2d 477 (Minn. 1985) (finding identity between the incorporated farm and its sole shareholder for the purposes of a Minnesota’s homestead exemption).

49. *See* KLEIN ET AL., *supra* note 24, at 117–22.

50. *See* *State Bank in Eden Valley v. Euerle Farms, Inc.*, 441 N.W.2d 121, 124 (Minn. App. 1989) (“[T]here was a strong degree of identity between the Euerles and Euerle Farms.”).

51. 26 U.S.C. §§ 1361–79 (2012 & Supp. 2014, 2015); Drew DeSilver, *What is a ‘closely held corporation,’ anyway, and how many are there?*, PEW RES. CTR. (July 7, 2014), <http://www.pewresearch.org/fact-tank/2014/07/07/what-is-a-closely-held-corporation-anyway-and-how-many-are-there/>.

52. 26 U.S.C. §§ 1362–63, 1366 (2012 & Supp. 2014).

53. *See* *Burwell v. Hobby Lobby Stores, Inc.*, 134 S. Ct. 2751 (2014); Drew DeSilver, *supra* note 51 (noting that Hobby Lobby is an S corporation).

that corporations and their shareholders can be indistinguishable.<sup>54</sup> The veil may be pierced because shareholders attempt to use the corporate form improperly to avoid personal liability,<sup>55</sup> or in recognition of the corporation's role as a placeholder for shareholders' rights or an "extension of [their] beliefs," neither of which are abandoned when they associate via the corporate form.<sup>56</sup>

Early-stage corporations fit well into the Shareholder Primacy framework. The shareholders behave as owners in all relevant ways, including controlling the firm's activities and assets. They are also able to control and police employee behavior and honesty. The board of directors is likely composed of the shareholders or those loyal to them. Profits earned or losses suffered by the firm are generally income or losses to the shareholders. That a court can pierce the corporate veil is evidence that shareholders own the firm: if the firm owned itself, there would be no one to whom to pierce. Stockholders' unity with their corporations means that their choices directly impact their well-being, making pursuit of nonwealth goals unproblematic.

It is difficult to maintain that a *sui generis* board hired capital (i.e., the shareholders who started the firm and elected the board); the board hires other production factors in place of shareholders only to

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54. In the family-farm cases, discussed *supra* notes 48 and 50, the court used reverse veil piercing to arrive at the unity of identity where the farms' natural owners enjoyed greater legal protections from creditors than did corporations. See Stephen M. Bainbridge, *Using Reverse Veil Piercing to Vindicate the Free Exercise Rights of Incorporated Entities*, 16 GREEN BAG 2d 235, 243-46 (2013).

55. *E.g.*, *Walkovszky v. Carlton*, 223 N.E.2d 6 (N.Y. 1966).

56. *Stormans, Inc. v. Selecky*, 586 F.3d 1109, 1120 (9th Cir. 2009); *EEOC v. Townley Eng'g & Mfg. Co.*, 859 F.2d 610, 620 (9th Cir. 1988); *Tyndale House Pubs., Inc. v. Sebelius*, 904 F. Supp. 2d 106, 115, 117 n.11 (D.D.C. 2012); *Roepke v. W. Nat'l Mut. Ins. Co.*, 302 N.W.2d 350, 351-53 (Minn. 1981); *see id.* at 352 (noting that other states have applied the doctrine in probate cases) (citing *State v. North*, 32 So. 2d 14 (Fla. 1947); *In re Burr's Estate*, 24 N.Y.S.2d 940 (Sur. Ct. 1941); *In re Estate of Greenfield*, 321 A.2d 922 (Pa. 1974)); *supra* notes 48-50; *see also* Stephen M. Bainbridge, *A Critique of the Corporate Law Professors' Amicus Brief in Hobby Lobby and Conestoga Wood*, 100 VA. L. REV. ONLINE 1, 4-5 & nn.17-18 (citing sources characterizing corporations as associations of individuals).

Family law also recognizes the concept, although it does not refer to it as veil piercing, when determining alimony, child support, and asset allocation between divorcing spouses. Brief of *Amici Curiae* Freedom X, et al. at 11-13 & nn.29-37, *Burwell v. Hobby Lobby Stores, Inc. & Conestoga Wood Specialties Corp. v. Burwell*, 134 S. Ct. 2751 (2014) (Nos. 13-354; 13-356) (citing cases from nine states).

The concept is not new. *See* Daniel Lipton, *Corporate Capacity for Crime and Politics: Defining Corporate Personhood at the Turn of the Twentieth Century*, 96 VA. L. REV. 1911, 1942-44 (2010) (citing early cases).

the extent that it is separate from them.<sup>57</sup> It is likewise difficult to maintain that nonshareholder production factors joined to hire the board.<sup>58</sup> Shareholders are almost certainly the ones with the special talent, product, or resource around which the enterprise was started.<sup>59</sup> Other constituencies like rank-and-file employees, creditors, or communities may not yet be in the picture.

Shareholders set the corporation's terms via the articles of incorporation at its formation. (The articles serve as a contract between the shareholders, in accord with the contractarian view of the firm.<sup>60</sup>) Their power is at its apex because they have not given away any of the sticks in the corporate bundle. Barring conflict among them, shareholders run their firm to achieve their desired ends, which may be laid out in the charter. In the event of conflict, the court will hold shareholders to their charter, though it is uncertain that courts would enforce a charter term opting out of shareholder wealth maximization.<sup>61</sup> The next question is whether and to what extent shareholder rights and their corporate ends survive as their firm outgrows the Simple Structure.

*b. Growth.* As firms mature, they develop systems and infrastructures to facilitate efficient output creation. Firms of this complexity necessarily have components beyond direct shareholder reach, necessitating professional managers. Standardization becomes ever more necessary, both for internal monitoring and efficient production. Professor Mintzberg calls the fully mature version of such

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57. See *supra* note 26 and accompanying text.

58. Blair & Stout, *supra* note 11, at 277 (describing the hiring and the giving up of rights in question as taking place when the corporation is formed); see *supra* text accompanying note 35. *But cf.* Blair & Stout, *supra* note 11, at 281 (describing the act of going public as the one that opts into the mediating hierarchy model).

59. *Cf.* Blair & Stout, *supra* note 11, at 275. All of this is subject, of course, to each party's relative bargaining power. When an "idea person" and a "money person" join to form a corporation, it is typically not merely the idea person who takes an equity stake. The money person will also take one, whether or not he or she also works for the firm. A special enough employee may likewise be able to bargain for equity, but at that point he or she becomes a shareholder with something special to offer the enterprise.

60. See *Boilermakers Local 154 Ret. Fund v. Chevron Corp.*, 73 A.3d 934, 939–40 (Del. Ch. 2013).

61. See *infra* Section III.A. Although the enforceability under current law of a charter provision opting out of shareholder wealth maximization is questionable, this Article argues that one should be cognizable if effectively noticed.

a firm a Machine Bureaucracy, and notes that it is characterized by centralized control, formality, and conflict among groups that comprise the organization.<sup>62</sup>

Share ownership may have spread beyond the founders,<sup>63</sup> but it is still a close corporation in which many of the original owners take an active managerial role. Ownership and control, therefore, are typically “joined in the hands of the small class of incorporators” that holds a majority of shares,<sup>64</sup> but that control is less direct and the minority can only influence firm affairs at the majority’s pleasure.

Shareholder Primacy continues to have descriptive value. As in earlier stages, it is difficult to characterize anyone but the shareholders as hiring directors. “[T]he controlling shareholder or shareholder group enjoy[s] near-absolute power to determine the firm’s future.”<sup>65</sup> The minority can (in theory) enforce its rights via direct and derivative suits, connoting that shareholders own the firm and employ the directors to pursue their ends. Veil piercing continues to be viable because abusive shareholders’ assets are still relatively easily targeted via lawsuit. Yet shareholders have given up some of their control sticks by delegating a significant number of business decisions to managers. But an enterprise’s being successful enough that stockholders require managerial assistance to run it does not mean that they have given up their rights to their contracted-for ends, as expressed in the corporate charter.

In line with Director Primacy, the board, directly and via subordinates, regularly hires production factors. To prevent abuse, directors owe fiduciary duties to all shareholders, including the minority, which can typically be fulfilled by treating the financial interests of all shareholders, *qua* shareholders, equally.<sup>66</sup> Yet to the extent that the board is composed of controlling shareholders’

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62. MINTZBERG, *supra* note 47, at 167–69, 171, 183, 280–81. Public corporations may also be machine bureaucracies. *See supra* note 44 and accompanying text.

63. Shares may become dispersed if the original shareholders sell, cause the firm to issue more shares to raise capital (such as when the firm goes public, discussed *infra*), or bequeath their shares to multiple parties.

64. Adam Winkler, “Other People’s Money”: *Corporations, Agency Costs, and Campaign Finance Law*, 92 GEO. L.J. 871, 906 (2004). This ownership structure typified even the largest firms of the first half of the nineteenth century. *Id.*

65. STOUT, *supra* note 1, at 16.

66. *Sinclair Oil Corp. v. Levien*, 280 A.2d 717 (Del. 1971).

representatives,<sup>67</sup> the control group can easily oust disfavored directors.

As Team Production predicts, however, the business judgment rule (BJR) makes it difficult for noncontrolling shareholders to vindicate their rights, freeing the board to act mostly as it pleases.<sup>68</sup> The board's centralized power is consistent with its need to coordinate and rein in conflict among the organization's internal constituencies. It must do so effectively if the firm is to produce efficiently. Nonetheless, the control group can replace the board anytime. And a classic corporate-law problem is that control groups, via their boards, abuse minorities' rights.

The shareholder class, therefore, continues to retain most control, and it can quickly retake that which it has delegated. Shareholders possessing minority interests have less power than others, but they are still owed fiduciary duties by the board and the shareholders who control it.<sup>69</sup> Intrashareholder duties may be difficult to enforce, especially when combined with the board's BJR protection.<sup>70</sup> But courts are more willing to find fiduciary duty violations in close corporations than public ones.<sup>71</sup> And the difficulty in proving a violation is a BJR feature that protects corporate pursuit of its purpose by insulating managerial decisions from opportunistic or litigious shareholders<sup>72</sup> in all but the most egregious cases of wrongdoing.<sup>73</sup> Shareholders, in sum, properly retain the right to have the firm run in

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67. As opposed to the controlling shareholders themselves.

68. Shareholders can seek redress by voting or suing. Their voting rights are limited to electing directors, approving charter and by-law amendments, mergers and sales of substantially all of the corporation's assets, and voluntary dissolution; they have no authority to dictate expenditures made in the ordinary course of business. DEL. CODE ANN. tit. 8, §§ 109, 211 (2011 & Supp. 2015). As a practical matter, even the activities on which they may vote are subject to significant board influence. See Bainbridge, *supra* note 27, at 105 & n.133; Winkler, *supra* note 64, at 902–03; J. Robert Brown, Jr., *Corporate Governance, Profit Maximization, and Hobby Lobby (Part I)*, THE RACETOTHEBOTTOM.ORG (July 10, 2014), <http://www.theracetothetbottom.org/the-sec-governance/corporate-governance-profit-maximization-and-hobby-lobby-par-1.html>.

69. See *In re MFW S'holders Litig.*, 67 A.3d 496 (Del. Ch. 2013); *Sinclair Oil*, 280 A.2d at 720, 723.

70. See *infra* note 185 and accompanying text; see also *infra* Section II.B.

71. Perhaps because inter-shareholder abuse born of voting control is easier to identify than managerial abuse in a public corporation.

72. See *infra* Section II.B.2–3.

73. See *infra* Section II.B.1.



accord with their original contract, whether it calls for the pursuit of wealth or another end.<sup>74</sup>

*c. Going public.* Although some firms remain private while they take advantage of economies of scale and scope to expand, the capital inflow generated by going public can finance growth exceptionally well. As shares are issued, their ownership becomes diffuse. Where a large enough block exists to constitute de facto control, the analysis is similar to that in the preceding section.<sup>75</sup> When no group is able to maintain control, the board of directors indeed becomes the supreme acting entity in the corporation, while shareholders are typically relegated to reacting to board decisions, and only if they can overcome collective-action problems.<sup>76</sup> The firms' size typically makes central authority necessary while making comprehensive central control impossible.<sup>77</sup> Boards, therefore, monitor divisions to which acting authority has been delegated. Professor Mintzberg calls this structure the Divisionalized Form, and notes that it is characterized by output standardization, autonomous divisions centrally monitored against quantitative goals, and central control primarily of division leadership.<sup>78</sup> Most control, in other words, is at least two steps removed from shareholders.<sup>79</sup>

Occam's razor<sup>80</sup> counsels that, even in relinquishing control in order to go public, stockholders retain enough rights from their

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74. See *infra* Section III.B; see also STOUT, *supra* note 1, at 16.

75. See ARTHUR R. PINTO & DOUGLAS M. BRANSON, UNDERSTANDING CORPORATE LAW § 10.04[D] & n.162 (3d ed. 2009) (discussing de facto control).

76. See *supra* note 68 and accompanying text; see also text accompanying note 30.

77. KENNETH J. ARROW, THE LIMITS OF ORGANIZATION 61–81 (1974).

78. MINTZBERG, *supra* note 47, at 215–25. Each division is essentially a self-contained entity that is monitored by and receives some support from the central authority (i.e., the board of directors and its direct reports in a typical corporation).

79. The divisions can be of different forms, including Simple Structures, Machine Bureaucracies, and other structures lacking strong central control. *Id.* at 217, 219, 224. The result is that intradivision control may also be decentralized.

80. Occam's razor is the problem-solving principle that "the simplest of competing theories is preferable to the more complex ones." BRYAN A. GARNER, GARNER'S MODERN AMERICAN USAGE 584 (3d ed. 2009). More appropriately for present purposes,

As Occam's Razor warns, once the possibility of a more complex palette of human motivation is introduced, the power of [a] theory sharply declines, for unless [one] can specify *when* self-interest will trump ideology (or a sense of fairness, or professional socialization, or whatever other motive) it will prove of little use either descriptively or prescriptively.

bundles to make it worth their while. For the founders, this almost certainly includes wealth creation alongside other personal goals.<sup>81</sup> For those who buy into a firm in which they lack control, wealth is more likely their motivation. Absent an explicit relinquishment, one should not assume that stockholders surrender their rights to their monetary or nonmonetary corporate ends to directors and other constituencies. After all, those rights are all that the shareholders have left.

Shareholders presumably give up their sticks on the best available terms. The residual-interest/wealth-maximization stick is the most versatile of the bundle,<sup>82</sup> allowing stockholders to pursue charitable and other nonwealth goals without a corporate or board intermediary deciding where to donate. It is presumably the right that they would relinquish last. Because profit motivates most stock purchases, one should assume, as the law does, that shareholders retain the wealth-maximization stick.<sup>83</sup>

Shareholder wealth maximization is thus a prerequisite, of sorts, to the existence of other purposes. Once established, stockholders should be free to alter firm ends if they believe that their nonwealth

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Cynthia R. Farina, *Faith, Hope, and Rationality or Public Choice and the Perils of Occam's Razor*, 28 FLA. ST. U.L. REV. 109, 116 (2000).

81. See, e.g., J. Travis Laster, *Revlon is a Standard of Review: Why it's True and What it Means*, 19 FORDHAM J. CORP. & FIN. L. 5, 12–14 (2013). Although going public is an efficient way to value the firm, cash out, and get rich, these are not founders' only motivations.

82. After all, each shareholder knows best which causes he or she would most like to support. It may be most efficient for a shareholder to make money through his or her share ownership, and donate the money as desired.

83. STEPHEN M. BAINBRIDGE, CORPORATION LAW AND ECONOMICS 469 n.16 (2002); SEC, STAFF REPORT ON CORPORATE ACCOUNTABILITY 35 (1980); Roberta Romano, *Answering the Wrong Question: The Tenuous Case for Mandatory Corporate Laws*, 89 COLUM. L. REV. 1599, 1611–12 (1989); see *infra* Part II. Although investors typically buy stock hoping to make money, profit need not be their only motivation.

Delaware is the de facto leader in corporate law which other jurisdictions regularly imitate. This Article thus focuses primarily, but not exclusively, on its laws and jurisprudence. Although Delaware and most states' laws adopt shareholder wealth maximization as law, see *infra* Part II, there are rare outliers where the strength of the norm is less certain—where it is less conclusive as a matter of positive law that stockholders retain the residual interest stick from the corporate bundle. See, e.g., *Intertherm, Inc. v. Olympic Homes Sys., Inc.*, 569 S.W.2d 467, 471 (Tenn. Ct. App. 1978) (“As a fiduciary, the officer or director has a strong influence on how the corporation conducts its affairs, and a correspondingly strong duty not to conduct those affairs to the unfair detriment of others, such as minority shareholders or creditors, who also have legitimate interests in the corporation but lack the power of the fiduciary.”). To the extent that this is the case, this Article argues that they should.

goals are best pursued via the corporate form and they sufficiently give notice to future share buyers.

To the extent that shareholder control is at its nadir while shareholder wealth maximization supported by enforceable fiduciary duties lives on, Director Primacy accurately portrays the public Divisionalized Form. It is also consistent with widespread share ownership that shareholders would relinquish significant power to enable board members to take actions without cumbersome second-guessing by multiple shareholders.<sup>84</sup> Nevertheless, shareholders do have ultimate voting power, which they have occasionally used, for example, to resist takeovers.<sup>85</sup>

Team Production's characterization of the board as a mediating body is descriptive inasmuch as the firms' divisions and other internal constituencies must be treated fairly and work together as needed, and shareholders need insulation from each other's opportunism. Yet it becomes harder to explain why it is proper for a board to be hired by, and thus work for, a factor with at least some interests directly adverse to the firm, like creditor-vendors or communities with whom tax deals may be sought, when the board properly acts as a trustee for the *corporation*.<sup>86</sup> It is also difficult to reconcile, absent an explicit choice to that effect, a decision by previously empowered shareholders to opt into a system that deprives them of their default and most versatile corporate stick,<sup>87</sup> and one that need not be surrendered to reduce transaction costs—the right to profits. Shareholder hands-tying does, however, facilitate widespread stock ownership and all that it enables.<sup>88</sup>

To the extent that veil piercing is no longer feasible because board members rather than shareholders are culpable for corporate wrongdoing, shareholders have indeed become more of a nonentity in the firm. But to the extent that that doctrine is unworkable merely because of the logistics of getting to many shareholders' assets, it does not diminish the notion that shareholders own the firm, as

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84. See *infra* Sections II.B.2–3; accord *infra* note 88 and accompanying text.

85. *E.g.*, RITA RICARDO-CAMPBELL, RESISTING HOSTILE TAKEOVERS: THE CASE OF GILLETTE 165–216 (1997).

86. Blair & Stout, *supra* note 11, at 280–81, 291; see also *infra* Section II.A.1.

87. See *supra* notes 82–83 and accompanying and following text.

88. See *infra* Sections I.B.2.b, II.B.3; accord *supra* note 84 and accompanying text.

Shareholder Primacy holds.<sup>89</sup> Shareholders are empowered to bring both direct and derivative suits, suggesting that they have retained the right to have directors work toward their ends. All of these characteristics are consistent with both wealth and nonwealth goals.

## 2. *On purpose*

The previous section shows that the corporation is a multifaceted entity capable of characterization across many dimensions. This section first distills the previous one's observations into the concept of a flexible, shareholder driven, corporate purpose. It then briefly discusses the state's reasons for chartering corporations.

*a. Corporate ends.* Corporations may be characterized as a coincidence of property, contractual, and associational rights. The Simple Structure, especially in its extreme forms like incorporated family farms, is most clearly its shareholders' property. At this stage, all incidents of ownership—all sticks in the ownership bundle—are in the shareholders' hands. They relinquish some sticks as the firm grows, but not their residual interest. This interest, this Article asserts, entitles shareholders to have their firms run either to maximize their wealth or to further other contracted-for ends.<sup>90</sup> This is equally true both of founding shareholders, who once possessed a complete property interest, and those who buy into the firm later. Shareholders do, however, surrender most control by the time the corporation goes public. But “separating control from ownership does not divest the

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89. The doctrine could be workable if blame for bad acts could be isolated to a few shareholders. *Cf.* *Stark v. Coker*, 129 P.2d 390 (Cal. 1942); *Jewell v. Victorian Vill. Internal Med.*, No. 08AP-919, 2009 WL 1314876, at \*2 (Ohio App. May 12, 2009) (unpublished).

90. See *infra* Section III.A for a proposal of how shareholders may opt out of having the firm run for their benefit. In effect, instead of taking possession of the profit and spending it on their desired nonwealth goals, they have the firm do it for them. See *supra* note 82 and accompanying text.

owner of his rights.”<sup>91</sup> The separation strikes this balance for the owners’ benefit, as discussed in Part II.<sup>92</sup>

The corporation is, simultaneously, a contract-facilitation entity. It internalizes contracts to save transaction costs and to alleviate the cost of incompleteness in a long-term relationship.<sup>93</sup> It also serves as a focal point at which production factors and customers voluntarily make value-creating exchanges.<sup>94</sup> But the contractarian account that denies corporate existence, and therefore purpose,<sup>95</sup> does not fully account for the firm as a historical bundle of rights, significant components of which shareholders retain. A natural corollary of the retention of rights is that the shareholder-owners are entitled to the wealth generated by their corporation, absent an explicit agreement to the contrary.<sup>96</sup> Under a purely contractarian account of the firm, by contrast, shareholder entitlement to *anything* must be intuited absent an explicit contract to that effect.<sup>97</sup>

Corporations, therefore, are not *merely* nexuses of contracts.<sup>98</sup> Although they need human action to enter into contracts, the contracts bind the firms even absent human agents. They are generally parties to the contracts for which they (or their boards) are nexuses.

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91. Bainbridge, *SWM Norm*, *supra* note 1, at 1426 n.9 (emphasis added). This statement implies that there is something of the corporation to own. Some Delaware cases agree. *E.g.*, *N. Am. Catholic Edu. Programming Found. v. Gheewalla*, 930 A.2d 92, 101 (Del. 2007); *Stahl v. Apple Bancorp, Inc.*, 579 A.2d 1115, 1124 (Del. Ch. 1990); *see also* *Fox v. CDX Holdings, Inc.*, C.A. No. 8031-VCL, 2015 WL 4571398 at \*1, \*24 (Del. Ch. July 28, 2015) (referring both to shareholders as owners and the influence of Director Primacy). *But see* Bainbridge, *SWM Norm*, *supra* note 1, at 1427 (stating that firms are not things that can be owned).

92. *See infra* Section II.B.2–3; *see also supra* text accompanying notes 37, 84.

93. “Over the course of such a relationship, issues arise that the participants did not anticipate. If it were possible to create a contract that specified every contingency at the outset (it is not), it would be costly beyond belief. The corporation facilitates the resolution of unforeseen issues by investing managers with command authority to address unanticipated circumstances without bargaining.”

George A. Mocsary, *Why the Corporation is Not Merely a Nexus of Contracts: A Response to Alexei Marcoux*, LIBR. L. & LIBERTY (Dec. 20, 2013), <http://www.libertylawsite.org/liberty-forum/why-the-corporation-is-not-merely-a-nexus-of-contracts>.

94. Marcoux, *supra* note 23. A “focal point” is a result to which individuals tend to gravitate in the absence of a distinct plan. *See* THOMAS C. SCHELLING, *THE STRATEGY OF CONFLICT* 57–63 (1980).

95. Marcoux, *supra* note 23; Bainbridge, *supra* note 24.

96. *See supra* note 83 and accompanying text.

97. *See supra* text accompanying note 25.

98. For more, see Mocsary, *supra* note 93.

Upon breach, corporations may be sued and *their* assets may be attached. They pay taxes. Corporations also enjoy constitutional and other higher-order rights that only make sense if they are placeholders for individuals.<sup>99</sup>

Associational rights, in other words, are entwined in the corporation. These rights can be seen as arising both from shareholders' mutual ownership of the corporate entity and their contracting through it. "Whether or not one accepts the notion that a corporation is a 'person,' some corporations are personal and associational in nature; that is, they are formed and owned by a single individual or by people who have decided to act in concert to undertake a trade or business."<sup>100</sup> When shareholders join together in a corporation, they do so to achieve their goals more efficiently than they otherwise could.<sup>101</sup> That the collective undertaking is pursued via the corporate form need not strip it of its end.<sup>102</sup> Stockholders choose their undertaking's terms, including its end, at the firm's founding. Later shareholders opt into the terms when buying their shares.<sup>103</sup>

Shareholders, managers, suppliers, and others have different individual purposes for contracting with one another. As the

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99. See *supra* note 56 and accompanying text; Ilya Somin, *Religious Freedom in the Commercial Sphere*, STAN. U. PRESS BLOG (Sept. 30, 2014), <http://stanfordpress.typepad.com/blog/2014/09/religious-freedom-in-the-commercial-sphere.html>; cf. KLEIN ET AL., *supra* note 24, at 119–20 (describing the use of "loan-out corporations" to obtain legal benefits for their sole shareholders).

The coincidence between some corporate and individual rights (whether statutory, constitutional, common-law based, etc.) does not mean that firms should always be treated as unitary with their shareholders. That would undermine some of the reasons for associating via the corporate form. See *supra* Section I.B.2.b; *infra* Section II.B.2–3.

100. J. William Callison, *Putting New Sheets on a Procrustean Bed: How Benefit Corporations Address Fiduciary Duties, the Dangers Created and Suggestions for Change*, 2 AM. U. J. L. & BUS. 85, 102 (2012).

101. See KLEIN ET AL., *supra* note 24, at 121–22 (describing the use of a shell corporation to make a merger more efficient); WILLIAM W. COOK, 1 A TREATISE ON STOCK AND STOCKHOLDERS, BONDS, MORTGAGES, AND GENERAL CORPORATION LAW § 1 n.1 (3d ed. 1894); see also *Burwell v. Hobby Lobby Stores, Inc.*, 134 S. Ct. 2751, 2768 (2014) ("A corporation is simply a form of organization used by human beings to achieve desired ends.").

102. It may do just that, however, if incorporation necessarily causes a legally mandated rule to displace the founders' original contract. This would happen, for example, if positive law required directors to run a corporation to maximize shareholder wealth, or to serve nonshareholder constituencies, irrespective of the founders' wishes.

103. Or they step into the shoes of the previous shareholders some other way, depending on how they acquired their shares. Charter amendments can change the terms mid-stream, to some stockholders' potential detriment. See *infra* Section III.C.2.

corporation aggregates these contracts, it aligns them toward the corporate purpose. “If . . . the invisible, intangible essence or air, which we term a corporation, can level mountains, fill up valleys, lay down iron tracks, and run railroad cars on them,—it can intend to do it.”<sup>104</sup> Or, at least, the law can require managers to act as if the firm had such an intent. The law should attempt to keep corporate direction true while ensuring that all constituencies receive the benefits of their bargains.

Managerial responsibility to pursue the corporate purpose becomes part of some contracts (e.g., those of managers), and dictates whether the firm enters into others (e.g., contracts with suppliers). It is the attainment of the corporate purpose that the board of directors must deploy its efforts and the firm’s resources. The board binds itself, under rules set by corporate law, to do so.<sup>105</sup> This Article proposes that the law recognize (1) both profit-based ends—for shareholders’ or another constituency’s benefit—and those unrelated to wealth; and (2) that a diffusely held firm, including a fully Divisionalized Form, can inherit such a purpose.

*b. The state’s purpose in chartering corporations.* Governments charter corporations because they make great contributions to the prosperity of modern economies. The benefits include those resulting from the state’s selling the privilege of incorporation, liability risk reduction, capital lock-in, and efficient transacting. Allowing corporations to pursue ends other than shareholder wealth should expand the number of corporations in existence, fueling more growth.

At the basest level, corporations provide revenue for the state in the form of filing and renewal fees,<sup>106</sup> create an extra level of taxation on corporate income,<sup>107</sup> and create a mechanism by which payroll and other taxes are reliably collected. The remaining business-enabling features, discussed next, create employment, a greater tax base, and a general circulation of wealth that results in economic growth.

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104. JOEL P. BISHOP, 1 NEW COMMENTARIES ON THE CRIMINAL LAW UPON A NEW SYSTEM OF LEGAL EXPOSITION § 417(4) (8th ed. 1892).

105. If the board resigned, a new one would be bound to pursue the same end.

106. It is safe to say that Delaware’s revenue from corporate filings alleviates its citizens’ tax burden, for example, by making a sales tax unnecessary.

107. Subchapter S corporations are the noteworthy exception. *See supra* text accompanying notes 51–53.

Nicholas Murray Butler, former President of Columbia University and Nobel Peace Prize winner, said that “the limited liability corporation is the greatest single discovery of modern times, whether you judge it by its social, by its ethical, by its industrial or, in the long run,—after we understand it and know how to use it,—by its political, effects.”<sup>108</sup> Limited liability shields shareholders from liability for their managers’ and co-owners’ acts, enabling diversification and closer-to-optimal risk taking.<sup>109</sup> This allows corporations to serve as laboratories, encouraging the private sector to experiment on socially beneficial undertakings.<sup>110</sup> Under the contrary partnership rule where partners are jointly and severally liable for the partnership’s debts, few individuals would be willing to become fellow shareholders with many strangers.<sup>111</sup> Without limited liability, modern corporations and the vastly expanded number of large undertakings that they make possible would be all but infeasible.

The corporate form also facilitates efficient transactions between the parties who meet at the nexus of contracts. It alleviates the hold-up problem, allowing investors to tie up capital with each other for the firms’ potentially perpetual existence.<sup>112</sup> A shareholder cannot cripple the enterprise by unilaterally withdrawing its investment, unlike a partner who typically can.<sup>113</sup> Shareholders also protect

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108. He continued: “Even steam and electricity are far less important than the limited liability corporation, and they would be reduced to comparative impotence without it.” Nicholas Murray Butler, President, Columbia Univ., Address at the 143rd Annual Banquet of the Chamber of Commerce of the State of New York (Nov. 16, 1911).

109. *Gagliardi v. Trifoods Int’l, Inc.*, 683 A.2d 1049, 1052 (Del. Ch. 1996). Absent protection, managers will tend to pursue less risky projects even if they have a lower expected payoff. Bainbridge, *supra* note 27, at 110–14. Shielding managers will incent them to undertake riskier projects with greater expected payoffs. *Id.* Shareholders tend not to mind the risk because they can diversify it away. *Id.* But see George A. Mocsary, *Statistically Insignificant Deaths: Disclosing Drug Harms to Investors (and Patients) Under SEC Rule 10b-5*, 82 GEO. WASH. L. REV. 111, 160 (2013) (noting that investors value predictability).

110. Cf. Roberta Romano, *The State as a Laboratory: Legal Innovation and State Competition for Corporate Charters*, 23 YALE J. ON REG. 209, 210 (2006).

111. See EASTERBROOK & FISCHER, *supra* note 9, at 41–42.

112. See Margaret M. Blair, *Locking In Capital: What Corporate Law Achieved for Business Organizers in the Nineteenth Century*, 51 UCLA L. REV. 404 (2003) (discussing “the problem that arises when one partner uses the threat of walking away from the business . . . to extract a greater share of the rents from the others”); see also *In re Trados Inc. S’holder Litig.*, 73 A.3d 17, 37 & n.4 (“Equity capital, by default, is permanent capital.”).

113. REV. UNIF. P’SHP ACT § 601 (1997); see also, STOUT, *supra* note 1, at 77–78. Assuming that stock markets are semi-strong efficient, as most scholars and economists believe,



themselves from each other by limiting their respective control rights over firm activities.<sup>114</sup> Corporations also reduce transaction costs by internalizing transactions, assuaging the costs of negotiating them across markets.<sup>115</sup> As President Butler said, “[The corporate form] substitutes co-operation on a large scale for individual, cut-throat, parochial, competition.”<sup>116</sup>

These benefits are consistent with, but neither depend on nor necessitate, a shareholder-profit goal: Shareholders desiring corporate ends other than wealth maximization ought to be able to purchase limited-liability protection. Capital lock-in can equally enable private undertakings and public works, which may be contracted out to existing private corporations or done by corporations directly chartered for the purpose.<sup>117</sup> Efficient transacting benefits all undertakings. Yet the state, by selling the right to incorporate to the wealth-seeking supermajority of stockholders, also produces social benefits.

## II. SHAREHOLDER WEALTH MAXIMIZATION IS THE NORM AND THE LAW

A corollary to the combination of (1) shareholders retaining the residual-interest stick from the corporate bundle, (2) that stick being the most versatile of the bunch, and (3) most stockholders investing in firms to make money, is that shareholder wealth maximization is the most natural default corporate purpose. This Part examines five of the most common objections to the shareholder wealth maximization norm and concludes that each is lacking. It also shows how facets of each claim that appear to weaken the norm in fact evince stockholder-driven corporate purpose. Part III builds on shareholder wealth maximization, showing that the law’s recognition of nonwealth

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*infra* note 201, a selling shareholder bears his or her share of a firm’s public bad decisions, which have been capitalized into its stock price; buying shareholders bear the risk of unpublicized bad decisions. Loose distribution rules, however, undermine this benefit. See George A. Mocsary, *The Embedded Firm: Corporate Governance, Labor, and Finance Capitalism—Commentary*, 3 ACCT., ECON. & L. 123, 126 (2014).

114. See *infra* Section II.B.3.

115. See Coase, *supra* note 22.

116. Butler, *supra* note 108, at 47.

117. See JAMES WILLARD HURST, *THE LEGITIMACY OF THE BUSINESS CORPORATION IN THE LAW OF THE UNITED STATES 1780–1970*, at 16–17 (1970).

corporate purposes would be both feasible and socially beneficial, and advocates for their validity.

*A. Claim #1: Improper Reliance on Dodge v. Ford*

One objection is that the germinal case of *Dodge v. Ford Motor Co.*<sup>118</sup> either (1) improperly invented the shareholder wealth maximization norm, (2) is improperly relied upon as precedent for the norm, or (3) was in fact about shareholder, rather than directorial, fiduciary duties.<sup>119</sup> The Dodge brothers, founders of the eponymous car maker and Ford shareholders, sued Ford to compel the continued payment of special dividends and enjoin the construction of a new manufacturing plant.<sup>120</sup> In response to statements and testimony by controlling shareholder Henry Ford that he was running Ford Motor Company for the benefit of employees, customers, and others, the Michigan Supreme Court compelled the dividend payment but allowed the plant to be built, stating:

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 stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end, and does not extend to a change in the end itself, to the reduction of profits, or the nondistribution of profits among stockholders in order to devote them to other purposes.<sup>121</sup>

As a threshold matter, any defects in *Dodge* or its interpretations are irrelevant because Delaware courts have repeatedly reaffirmed the shareholder wealth maximization norm, including within the last year.<sup>122</sup> That said, *Dodge* is instructive for its enunciation of the

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118. 170 N.W. 668 (Mich. 1919).

119. *E.g.*, Lynn A. Stout, *Why We Should Stop Teaching Dodge v. Ford*, 3 VA. L. & BUS. REV. 163 (2008).

120. *Dodge*, 170 N.W. at 673, 677.

121. *Id.* at 683–84, 685; ALLAN NEVINS & FRANK E. HILL, *FORD: EXPANSION AND CHALLENGE, 1915–1933*, at 99–100 (1957).

122. *See infra* Section II.C.1 and notes therein; *RBC Capital Markets, LLC v. Jervis*, 129 A.3d 816, 849 (Del. 2016) (“Revlon neither creates a new type of fiduciary duty in the sale-of-

longstanding view that managers must run their corporations for stockholder benefit.

*1. Dodge embodies ubiquitous societal understanding*

Some have argued that *Dodge's* statement of corporate purpose was dicta unsubstantiated by legal authority.<sup>123</sup> Yet *Dodge* merely made explicit that which had been an implicit and axiomatic part of the common law and general societal agreement. Societal understanding is critical to defining the corporate contract's *implicit* terms because constituencies "ought to get out of their agreements what they were promised in their agreements."<sup>124</sup>

*Dodge's* view of shareholders as the corporation's residual claimants to whom the directors owe a duty of wealth maximization was a succinct restatement of the preceding several decades of Michigan common law.<sup>125</sup> *Hunter v. Roberts, Thorp & Co.*,<sup>126</sup> in particular, cited in *Dodge's* analysis of whether a dividend should be forced,<sup>127</sup> is strikingly similar to *Dodge* and is especially instructive. *Roberts, Thorp & Co.*, a manufacturer of threshing machines, was

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control context nor alters the nature of the fiduciary duties that generally apply. Rather, Revlon emphasizes that the board must perform its fiduciary duties in the service of a specific objective: maximizing the sale price of the enterprise." (quoting *Malpiede v. Townson*, 780 A.2d 1075, 1083–84 (Del.2001)); *Andrikopoulos v. Silicon Valley Innovation Co.*, 120 A.3d 19, 25 (Del. Ch. 2015); *In re Books-A-Million, Inc. S'holders Litig.*, C.A. No. 11343-VCL, 2016 WL 5874974, \*11–12 (Oct. 10, 2016); *OptimisCorp v. Waite*, C.A. No. 8773-VCP, 2015 WL 5147038, \*61 & n.520 (Del. Ch. Aug. 25, 2015); *In re Appraisal of Dell Inc.*, C.A. No. 9322-VCL, 2016 WL 3186538, \*25–26 (Del Ch. May 31, 2016).

123. Stout, *supra* note 119, at 167–68; Lyman Johnson & David Millon, *Corporate Law After Hobby Lobby*, 70 BUS. LAW. 1, 12 (2015).

124. Marcoux, *supra* note 23.

125. See *Union City Lumber Co. v. Traverse City, L & M Ry. Co.*, 136 N.W. 463, 468 (Mich. 1912) ("Stockholders of a corporation are permitted . . . to have a proportional share in corporate success."); *Stroh v. City of Detroit*, 90 N.W. 1029, 1030 (Mich. 1902) ("[I]t is undeniable that [shareholders] bear the burden of the tax imposed upon the corporation, inasmuch as the shareholders constitute the corporation and indirectly own its property."); *Ackenhausen v. People's Sav. Bank*, 68 N.W. 118, 120 (Mich. 1896) (noting that depositors have a contractual relationship with a bank by which their interests are protected while "the profits of the business all belong to the stockholders."); *Butterfield v. Beardsley*, 28 Mich. 412, 425 (1874) ("If a quantity of oil had been drawn from a company well it must have belonged to the company, and ultimately to the shareholders according to their respective stockholding rights. The same must be true of the well itself, and of the other property."); *infra* notes 126–132 and accompanying text.

126. 47 N.W. 131 (Mich. 1890).

127. *Dodge v. Ford Motor Co.*, 170 N.W. 673, 682 (Mich. 1919).

sued by a former shareholder's estate to compel the payment of dividends.<sup>128</sup> Unlike in *Dodge*, the board maintained that it refrained from paying dividends as part of its long-term business strategy.<sup>129</sup> The Supreme Court of Michigan ratified the lower court's statement that: "It is undoubtedly true that the ultimate object for which every corporation of the character of the one under consideration [machine manufacturing] is formed, is the payment of dividends to its individual members."<sup>130</sup> Directors, the court said, "are the legally appointed agents and trustees of the stockholders."<sup>131</sup> The dissent agreed on both points.<sup>132</sup> Other states had similar case law,<sup>133</sup> and contemporaneous treatises agreed.<sup>134</sup> Diffusely held corporations were among those

128. *Hunter*, 47 N.W. at 131. Suits attempting to compel the payment of dividends were not uncommon around the turn of the century.

129. *Id.*

130. *Id.* at 131, 133. Absent disparate tax treatment, dividends and capital appreciation are interchangeable ways in which to realize gains on a stock investment.

131. *Id.* at 133.

132. *Id.* at 138, 139.

133. *See, e.g.*, *U.S. Radiator Corp. v. State*, 101 N.E. 783, 785 (N.Y. 1913) ("A share of corporate stock is the right which the shareholder has to participate . . . in the surplus profits of the corporation on a division, and in the assets or capital stock remaining after payment of its debts on its dissolution or the termination of its active existence and operation."); *People ex rel Venner v. N.Y. Life Ins. Co.*, 111 A.D. 183, 187 (N.Y. App. Div. 1906) ("The stock owned by [a shareholder] makes him the equitable owner of an undivided fractional part of the future assets of the company . . . . The stockholder's rights in the profits of the business flow from his proprietary interest, and have no analogy to the rights of a contract creditor."); *Lord v. Equitable Life Assurance Soc.*, 94 N.Y.S. 65, 78 (N.Y. Sup. Ct. 1905) ("Directors of a corporation are not vested with the title to the property of the corporation. They are agents of the corporation, upon whom duties devolve of management and care—the exercise of corporate powers for the benefit of the equitable owners of the corporate property, the stockholders. The directors are the trustees, and the stockholders are the cestuis que trust." (quoting *Dykman v. Kenney*, 154 N.Y. 483, 491 (1897)) (internal quotation marks and alterations omitted)); *Jones v. Terre Haute & Richmond R.R. Co.*, 57 N.Y. 196, 205, 206 (1874) ("[A] stockholder in a corporation has an interest, in proportion to his stock, in all the corporate property, and has a right to share in any surplus of profits arising from its use and employment in the business of the company" and "[the corporation's] affairs [are] managed by the directors as trustees for the stockholders."); *King v. Patterson & Hudson R.R. Co.*, 29 N.J.L. 82, 88 (1860) ("The directors are the agents of the corporation, and in their official capacity agents of the stockholders also."); *Brightwell v. Mallory*, 18 Tenn. 196, 198 (1836) (stating stock entitles its holder "to his proportion of the profits or dividends which may be declared from time to time, and, when the institution closes the business, to his proportion of the capital stock and profits which may remain to be divided").

134. ARTHUR W. MACHEN, JR., 1 A TREATISE ON THE MODERN LAW OF CORPORATIONS §§ 496, 508, 1313 (1908); COOK, *supra* note 101, §§ 12, 641, 643, 648 (aggregating dozens of cases); HENRY O. TAYLOR, A TREATISE ON THE LAW OF PRIVATE CORPORATIONS HAVING CAPITAL STOCK §§ 558–59, 564, 567, 692 (1884).

understood to be managed for shareholder benefit.<sup>135</sup> Stockholders' contracts with their firms demanded wealth maximization.

The Great Wall Street Scandal of 1905 provided an opportunity for all facets of society to express their views on the topic. The scandal was ignited by the revelation that managers of several insurance companies—the corporations most quickly and thoroughly to adopt a business model separating ownership from control—were using company funds for both direct personal benefit and to finance political campaigns.<sup>136</sup> The uproar over the contributions and abuses was massive, and based primarily on the common understanding that corporate managers were “thieves and embezzlers” improperly spending “other people’s money”<sup>137</sup>—money that belonged to policyholder- and stockholder-owners.<sup>138</sup> It soon became clear that other firms’ managers were equally culpable.<sup>139</sup> Condemnation was universal, coming from the public,<sup>140</sup> media,<sup>141</sup> religious leaders,<sup>142</sup> state politicians,<sup>143</sup> congress,<sup>144</sup> and even President Theodore Roosevelt.<sup>145</sup>

Managers were seen as both stealing outright and creating “forced political association”<sup>146</sup> between owners and candidates whom the owners disfavored, and who enacted laws insulating managers from owner lawsuit.<sup>147</sup> One writer described these latter measures as

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135. Small investor groups dominated even the largest firms until the mid-nineteenth century. Winkler, *supra* note 64, at 906–12. Soon thereafter, however, starting with railroads and insurance companies and spreading rapidly to other firms, separation of ownership from control became the norm. *Id.*

136. *Id.* at 887–93.

137. *Id.* at 887, 893.

138. Some insurance companies were organized as mutual companies, where policyholders are the firms’ owners and are entitled to dividends, while others were organized as stock corporations. *Id.* at 901. Both policyholders and stockholders were considered owners from whom managers were stealing. *Id.* at 900–01, 905–06, 910–11. “[T]he funds held by the firm did not belong to the company *per se* as some distinct entity with its ‘own’ money.” *Id.* at 894.

139. *See id.* at 906–12.

140. *Id.* at 891, 893–95.

141. *Id.* at 893, 915–16.

142. *Id.* at 893–94.

143. *Id.* at 888, 893.

144. *Id.* at 924, 929.

145. *Id.* at 920.

146. *Id.* at 895–98.

147. *Id.* at 907–09; *see id.* at 909–12.

“designed to protect the policy-holders from *their own servants*.”<sup>148</sup> Managers defended on the ground that they were serving owner interests, referring to themselves as the owners’ trustees.<sup>149</sup> Shareholder and policyholder interests were the benchmark. That ownership and control diverged was not seen as destroying ownership interests. The principal-agent view of the firm was taken for granted.<sup>150</sup> This understanding continues.

Notwithstanding the potential—and actual—managerial abuse that accompanied the rise of the manager-controlled corporation, the model was spectacularly successful, resulting in extraordinary growth.<sup>151</sup> Yet the costs of weaker managerial accountability were impossible to ignore. The new model’s unprecedented capacity for wealth creation ensured its survival,<sup>152</sup> even while the potential for managerial abuse ballooned. It is logical, therefore, that courts would make the shareholder-wealth-maximization standard of conduct more explicit, while preserving the benefits that came with the new manager-friendly standard of review.<sup>153</sup> This era also saw the advent of the BJR.<sup>154</sup> Section B analyzes the BJR after the following brief discussion of how construing *Dodge* as a controlling-shareholder case is consistent with the shareholder wealth maximization norm.

## 2. A controlling-shareholder analysis of *Dodge* supports a shareholder-driven approach to corporate purpose

Some scholars view *Dodge* as standing only for the proposition that majority shareholder Henry Ford could not freeze “protesting, minority stockholders”—the Dodge brothers—out of their special dividends.<sup>155</sup> Ford very likely *was* attempting to deprive the Dodge

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148. *Id.* at 900 (quoting *The Skeleton in the Insurance Closet*, COLLIER’S, Oct. 14, 1905, at 13) (emphasis added).

149. *Id.* at 890, 898.

150. *Id.* at 873–76, 911–14, 918–23.

151. *Id.* at 909–10; see also STOUT, *supra* note 1, at 103–04.

152. See Sharfman, *supra* note 14, at 401–06; text accompanying note 151.

153. See *infra* Section II.B.1.

154. *Id.* at 908.

155. *E.g.*, D. Gordon Smith, *The Shareholder Primacy Norm*, 23 J. CORP. L. 277, 315–20 (1998); Blair & Stout, *supra* note 11, at 301–02; Cynthia Williams, *The Future of Shareholder Wealth Maximization: A Response to George Mocsary*, LIBR. L. & LIBERTY (Dec. 23, 2013), <http://www.libertylawsite.org/liberty-forum/the-future-of-shareholder-wealth-maximization-a-response-to-george-mocsary>.

brothers of Ford's generous special dividends, which the Dodge brothers were using to finance their car company.<sup>156</sup> Yet an improper<sup>157</sup> dividend freeze-out is at base a situation in which shareholder wealth is not being maximized in a close corporation. In the archetypical situation, managers redistribute wealth to themselves at the expense of shareholders generally. In a freeze-out, a controlling shareholder or group, through board control, appropriates wealth from a subset of shareholders.<sup>158</sup> Both are unacceptable because they impede long-term stockholder wealth. Both apply with equal strength to situations where managers or empowered shareholders are impeding other nonwealth corporate ends.

If, as interest-balancing theories suggest, the board of directors has plenary power<sup>159</sup> in a firm to serve various constituent interests as corporate (as opposed to shareholder) needs dictate, then Henry Ford did exactly what he was supposed to via his board: fight off a genuinely threatening<sup>160</sup> competitor. He was thus serving all corporate constituencies by working toward the continued health of Ford Motor Company. Indeed, and also in accord with shareholder-interest-driven theories, he pursued even the Dodge brothers' interests, *qua* Ford

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The reason not to view *Dodge* as a freeze-out case is that the court tied its prohibition on the nondistribution of profits to Ford's (supposed) altruism. *Dodge v. Ford*, 170 N.W. 668, 684 (Mich. 1919); see Stephen M. Bainbridge, *Is Dodge v. Ford Motor Company a close corporation/controlling shareholder case?*, PROFESSORBAINBRIDGE.COM (May 5, 2012), <http://www.professorbainbridge.com/professorbainbridge.com/2012/05/is-dodge-v-ford-motor-company-a-close-corporationcontrolling-shareholder-case.html>.

156. See NEVINS & HILL, *supra* note 121, at 89–91 (noting that Ford's proposal would have left the Dodge brothers with a \$120,000/year normal dividend instead of \$1,200,000/year if the special dividend were also paid); Smith, *supra* note 155, at 316 & n.201; Blair & Stout, *supra* note 11, at 301 & n.132.

157. It is proper for a board to refuse to pay dividends to pursue long-term firm value rather than accede to a short-term demand for cash from a minority shareholder.

158. In the absence of dividend payments, minority shareholders can only see a return on their investments by collecting a salary or selling their shares to realize capital gain. *Cf. supra* note 130. The former is only possible if the controlling shareholder assents, and the latter is typically very difficult in the absence of a public share market. That said, shares of the spectacularly successful Ford Motor Company were likely much easier to sell to a third party than other stock was, albeit at a risk discount. By contrast, even in the absence of a dividend, a controlling shareholder can pay him or herself a salary and sell his or her controlling interest to fully realize capital gain.

159. See *supra* Section I.A.3; *infra* Section II.E.

160. NEVINS & HILL, *supra* note 121, at 8, 394.

shareholders, via the increase in value that Ford Motor Company would see from Dodge Motorcar's loss of a reliable source of capital.

*B. Claim #2: The Business Judgment Rule Does Not Require Managers to Maximize Shareholder Wealth*

The next argument is that managers have no “enforceable legal duty to maximize shareholder wealth” because, under the BJR, they have wide autonomy in managing their firms' affairs and are routinely exculpated from liability despite having lost firm money.<sup>161</sup> This argument conflates the standard of managerial conduct with the standard that courts use to review it. Managerial duties to pursue shareholder wealth are regularly enforced with varying standards of review appropriate to different situations. These standards, which developed organically through the common law, presumably strike an equilibrium between shareholder power and managerial accountability. They are consistent with enabling boards to efficiently pursue stockholder ends.

*1. The business judgment rule*

Managers must attempt to maximize shareholder wealth, but they need not succeed. Shareholder wealth maximization, as it is adjudicated under the BJR, is a standard of conduct to which managers must adhere. It does not require a particular financial result, much less optimal decision making that results in actual wealth maximization. Managers incur no liability for injury to their corporations resulting from actions pursued in good faith and with reasonable care.

The BJR is the standard against which manager pursuit of shareholder wealth is reviewed. Absent some incentive irregularity—evidence suggesting that managers either acted self-interestedly or otherwise contrary to their duties—courts will abstain from a fairness review of managerial decisions and presume that they were made in pursuit of shareholder wealth.<sup>162</sup> In this case, the review is essentially

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161. STOUT, *supra* note 1, at 25, 29–31; *see, e.g.*, David Millon, *Radical Shareholder Primacy*, 10 U. ST. THOMAS L.J. 1013, 1020 (2013); Mitchell, *supra* note 1, at 623–24, 626, 631–32.

162. *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984); *see Kamin v. Am. Exp. Co.*, 383 N.Y.S.2d 807, 812 (Sup. Ct. 1976). This Article's framework for analyzing the BJR considers



no review. If an incentive irregularity is present, however, the depth of review varies.

Where managers' acts are not suspected of being tainted with a financial interest, lack of independence, or an entrenchment motive, scrutiny remains low. Courts will typically intervene only if managers were grossly negligent in informing themselves about an issue;<sup>163</sup> "absent a conscious decision, failed to act";<sup>164</sup> had no rational basis for their decision;<sup>165</sup> or engaged in fraud or other illegality.<sup>166</sup> A finding of fault under these categories is rare—to the point that they are best thought of as indicators of an otherwise unseen incentive irregularity.<sup>167</sup>

When the board must decide whether to accept a takeover bid, there is an "omnipresent specter" of board entrenchment at shareholder expense because bid acceptance will usually result in the board members' losing their jobs.<sup>168</sup> If the board rejects a bid, *Unocal*

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the typical categorization of inquiries into managerial behavior concerning the duties of loyalty and care largely irrelevant. *See, e.g.*, *Bayer v. Beran*, 49 N.Y.S.2d 2, 6 (Sup. Ct. 1944) (distinguishing between the BJR and the "rule of undivided loyalty"). *But see Brehm v. Eisner*, 746 A.2d 244, 264 (Del. 2000) (referring to good faith as "a key ingredient of the business judgment rule"). Relevant for present purposes are the situations in which courts will employ their equity powers not to defer to the board's broad statutory authority to run the firm. *Bodell v. Gen. Gas & Elec. Corp.*, 140 A. 264, 267 (1927). The Delaware Supreme Court firmly presumed the validity of board actions. *Id.* The Chancery Court, which perhaps better explained the tension between statutory authority and equity, instead put the burden on the board to prove the fairness of the challenged transaction. *Bodell v. Gen. Gas and Elec. Corp.*, 132 A. 442, 446, 448 (Del. Ch. 1926).

163. *Smith v. Van Gorkom*, 488 A.2d 858, 873 (Del. 1985).

164. *Aronson*, 473 A.2d at 813 & n.7; *see Francis v. United Jersey Bank*, 432 A.2d 814 (N.J. 1981).

165. *Brehm*, 746 A.2d at 264 (citing *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971)).

166. *Sinclair Oil*, 280 A.2d at 722; *Shlensky v. Wrigley*, 237 N.E.2d 776, 779–80 (Ill. App. Ct. 1968); *Kamin*, 383 N.Y.S.2d at 812; *In re Walt Disney Co. Derivative Litig.*, 907 A.2d 693, 753 (Del. Ch. 2005).

167. In the case of a positive law violation, proof of the violation serves to create liability. Yet even this category may be considered a sign of a hidden incentive irregularity given that the violation may have been committed to advance corporate goals. *See Auerbach v. Bennett*, 393 N.E.2d 994 (N.Y. 1979) (dealing with bribes made to secure business). In cases where the manager benefits from the illegality, he or she has a material financial interest or is simply robbing the firm. *See infra* text accompanying note 171.

168. *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954, 955 (Del. 1985); *see also* Laster, *supra* note 81, at 11–18 & n.45 (listing reasons for managerial misbehavior in the takeover context); J. Travis Laster, *Omnicare's Silver Lining*, 38 J. CORP. L. 795, 808–11, 816 (2013) (same).

*Corp. v. Mesa Petroleum* mandates an intermediate level of scrutiny: the board must prove that it reasonably perceived a threat to the corporate enterprise and that its response was “reasonable in relation to the threat posed.”<sup>169</sup> If the board makes this showing, the burden shifts back to the plaintiff to show another reason for overturning the board’s decision.<sup>170</sup>

Where managers have a material financial interest in their decisions or lack independence, the incentive irregularity is obvious and courts will shift the burden of proof to managers and require them to prove that their actions were entirely fair to the corporation.<sup>171</sup>

## 2. *The rule as bargain between shareholders and management*

This combination of a strict wealth maximization principle and a stepped standard of review results from an implicit bargain<sup>172</sup> between shareholders and managers: shareholders would not invest in a firm if managers could whimsically deploy their investment to serve other constituencies, and managers would not work for a firm if accepting employment meant that they had to guarantee optimal returns.

Managers know the business under their charge best, and should be allowed to use their discretion in running it. The BJR protects managers from shareholder second-guessing. It is in shareholders’ interests to offer managers this protection for actions taken in good

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169. *Unocal*, 493 A.2d at 953, 955. The distinction between *Unocal*, which applies in contexts where there is no inevitable sale of the company or transfer of control that would subject shareholders to the risks and consequences borne by holders of minority shares, and *Revlon v. MacAndrews & Forbes Holdings*, 506 A.2d 173 (Del. 1986), which applies where such a sale or transfer of control is certain, is discussed *supra* Section II.C.1 and note 203. *Revlon* is properly considered a subcategory of *Unocal* in which the board has fewer courses of action available to it. See Laster, *Revlon*, *supra* note 81, at 11–12; David G. Yosifon, *The Law of Corporate Purpose*, 10 BERKELEY BUS. L.J. 181, 188–93, 198–202 (2013). *Revlon* thus provides an intermediate-plus form of scrutiny.

170. *Unocal*, 493 A.2d at 954 (requiring “judicial examination at the threshold before the protections of the business judgment rule may be conferred”). The *Unocal* test is quite permissive in its implementation. Bernard S. Sharfman, *The Tension Between Hedge Fund Activism and Corporate Law*, 1 J. L., ECON. & POL’Y (forthcoming 2016).

171. Laster, *supra* note 168, at 812; *Weinberger v. UOP, Inc.*, 457 A.2d 701, 711 (Del. 1983); *Guth v. Loft, Inc.*, 5 A.2d 503, 510 (Del. 1939); see Sharfman, *supra* note 14, at 399, 410.

172. That it is a bargain is evidenced by the ability of the shareholders to alter the default terms of their relationship with managers in the certificate of incorporation. DEL. CODE ANN. tit. 8, §§ 102(b)(7), 141(a) (Supp. 2015); see also DEL. CODE ANN. tit. 8, § 351 (2011) (statutory close corporations); accord *infra* note 178.

faith and with appropriate care to ensure closer-to-optimal managerial risk taking.<sup>173</sup> Shareholders thus bind themselves to be unable to sue managers, save in the presence of grave incentive irregularity or potential for abuse.<sup>174</sup>

In the absence of abuse, less day-to-day accountability to shareholders—more authority in the board—is typically more efficient because it reduces transaction costs, facilitates coordination, reduces the cost of disputes, and the like.<sup>175</sup> Yet when an incentive irregularity is present, the need for accountability<sup>176</sup> increases. The BJR’s stepped standard of review fulfills the bargain between shareholders and managers.

### 3. *The rule as bargain among shareholders*

The BJR, combined with public shareholders’ meager retained control rights,<sup>177</sup> also fulfills a hands-tying bargain among shareholders.<sup>178</sup> Managers have the most direct knowledge about the business, and are therefore best positioned to make corporate decisions.<sup>179</sup> Individual shareholders, with their diverging interests, benefit by enabling managers to act independently, free of the risk of other shareholders suing managers for making “wrong” decisions that were undesirable to the plaintiffs only.<sup>180</sup> Some shareholders would lack the resources to sue, resulting in managers catering to both litigious shareholders and judicial expectations.<sup>181</sup> A positive side effect of this bargain is that shareholders are also less able to act

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173. See *supra* note 108.

174. See Bainbridge, *supra* note 27, at 108–09; Blair & Stout, *supra* note 11, at 312; *supra* Section II.B.1. Even uninhibited by the BJR, shareholders only get to make a case on the merits.

175. See Sharfman, *supra* note 14, at 402–05; Bainbridge, *supra* note 27, at 105–06.

176. “Accountability” means just that—that managers must account for their actions. If they do they are not liable. See *supra* Section II.B.1; *supra* note 174.

177. See *supra* note 68.

178. As with the bargain between shareholders and management, this contract is alterable. DEL. CODE ANN. tit. 8, §§ 102(b)(7), 141(a) (Supp. 2015); see also *id.* § 351 (allowing statutory close corporations); accord *supra* note 172.

179. See Bainbridge, *supra* note 27, at 106.

180. STOUT, *supra* note 1, at 9, 68, 76–83; Bainbridge, *supra* note 12, at 557.

181. See Sharfman, *supra* note 14, at 409; Stephen M. Bainbridge, Unocal at 20: *Director Primacy in Corporate Takeovers*, 31 DEL. J. CORP. L. 769 (2006).

opportunistically, to the business's long-run detriment, with respect to other constituencies.<sup>182</sup>

It is also inefficient and expensive for the firm and its managers to be fighting lawsuits rather than pursuing the firm's ends. Given that managers are the best-positioned decision makers, the BJR is therefore also a contract among shareholders to keep judges, who "are not business experts" and are expensive to use, from deciding firm policy.<sup>183</sup>

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Weakness is a strength when it comes to credible commitment. Shareholders voluntarily tie their hands vis-à-vis managers and one another—and, by extension, employees, bondholders, and other constituencies—via the BJR to enable their collective enterprise to efficiently pursue their ends. The law assumes, but the BJR's reasoning does not demand, a pecuniary end. Shareholders are entitled to have their firms run to pursue those ends,<sup>184</sup> and retain the ability to enforce their rights in the most obviously dire circumstances. An unfortunate side effect of this bargain, however, is that it provides good cover for managerial actions misaligned with shareholder goals.<sup>185</sup> That does not, however, change the propriety of those actions.<sup>186</sup>

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182. See STOUT, *supra* note 1, at 74, 80, 85; *infra* text accompanying and following note 226.

183. *Dodge v. Ford Motor Co.*, 170 N.W. 668, 684 (Mich. 1919); see Bainbridge, *supra* note 27, at 106, 117–24. This notion is not new. *Hunter v. Roberts, Throp & Co.*, 47 N.W. 131, 131 (Mich. 1890) ("Whether a corporation can safely make a dividend involves the exercise of knowledge and judgment, and the power of deciding this question should not be taken from the directors, and assumed by the courts, unless it clearly appears that the directors have mistaken their legal duties. Any other rule would lead to the frequent intervention of the courts, to the substitution of the court for the board of directors, and in very many instances, would prove disastrous to the best interests of the corporation and its stockholders, and the business . . . would be seriously hampered and retarded.").

184. The opposite view taken to its extreme, would allow, for example, a target board in a takeover bid to reject the bid purely for the benefit of the bidder's shareholders, who the board may believe are not getting a good value. *Supra* Section I.A.3; STOUT, *supra* note 1, at 88–89.

185. See STOUT, *supra* note 1, at 32–33; Laster, *Reylon*, *supra* note 81, at 28 (observing that an admission of improper behavior is all but necessary under the lowest levels of BJR review); J. Haskell Murray, *Choose Your Own Master: Social Enterprise, Certifications, and Benefit Corporation Statutes*, 2 AM. U. BUS. L. REV. 1, 15 (2012) (same). Compare *infra* text accompanying notes 190–191 (discussing the negative effects on shareholders of potentially disloyal actions by Time's board) with *infra* text accompanying notes 192–193 (discussing the positive effects on shareholders of likely proper actions by Airgas's board).

186. *Accord* Yosifon, *supra* note 169, at 223–26. Scholars differ on the extent to which shareholder wealth is pursued by managers. See *infra* notes 357–358 and accompanying text.

*C. Claim #3: The Common Law Has Disclaimed Shareholder Wealth Maximization*

Just as the common law has not indirectly foreclosed shareholder wealth maximization via the BJR, it has not done so directly, either. The arguments to the contrary fall into two categories: (1) the Delaware Supreme Court has not stated that shareholder wealth maximization is the standard to which corporate boards' conduct is held, and (2) boards' fiduciary duties run to "the corporation and its shareholders," rather than solely to the shareholders. These arguments are grounded in judicial language that, viewed in isolation, may suggest that pursuing shareholder interests is optional. When examined in proper context, however, it is clear that the referenced language mandates long-term pursuit of stockholder interests, which are appropriately presumed to be shareholder value which may (but need not) be best achieved by maximizing stock price today.

*1. The proper time horizon*

Many cases contain disclaimers of short-term shareholder wealth maximization that, read in isolation, may be read to disclaim wealth maximization altogether. *Paramount Communications, Inc. v. Time Inc.* and *Air Products & Chemicals, Inc. v. Airgas Inc.*, for example, state that a corporate board "is not under any *per se* duty to maximize shareholder value in the short term."<sup>187</sup> Both courts note, however, that the boards' actions were acceptable because they were pursuing "long-term value for the stockholders."<sup>188</sup> In *Unocal* and elsewhere,

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187. *Air Prods. & Chems., Inc. v. Airgas, Inc.*, 16 A.3d 48, 98 (Del. Ch. 2011) (citing *Paramount Commc'ns, Inc. v. Time Inc.*, 571 A.2d 1140, 1150 (Del. 1990)); *see, e.g.*, STOUT, *supra* note 1, at 30 (citing *Airgas* as a disclaimer of shareholder wealth maximization); Blair & Stout, *supra* note 11, at 304 & n.146 (noting that the *Time* court allowed the board to reject a tender offer to preserve "Time culture," with no connection to long-term shareholder wealth); Williams, *supra* note 155 (same).

188. *Time*, 571 A.2d at 1149; *Airgas*, 16 A.3d at 102; *see Time*, 571 A.2d at 1148-50, 1153-55; *Airgas*, 16 A.3d at 99-103.

Other commonly cited disclaimers of short-termism include *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985) and *Shlensky v. Wrigley*, 237 N.E.2d 776 (Ill. App. Ct. 1968); *see, e.g.*, Blair & Stout, *supra* note 11, at 303, 308; Mitchell, *supra* note 1, at 613. The *Unocal* court stated that in deciding whether to fight a takeover bid, a board may consider, in addition to the price, "the impact on 'constituencies' other than shareholders (i.e., creditors, customers, employees, and perhaps even the community generally)." *Unocal*, 493 A.2d at 955. But as Professor David G. Yosifon ably shows, these constituencies may only be considered if

Delaware's Supreme and Chancery Courts have affirmed that it is a "basic principle that corporate directors have a fiduciary duty to act in the best interests of the corporation's stockholders," and have a "legal responsibility to manage the business of a corporation for the benefit of its shareholder owners."<sup>189</sup>

One might answer that both the *Time* and *Airgas* boards' actions were "demonstrably not shareholder wealth maximizing" because they declined to sell their firms for a substantial premium.<sup>190</sup> This is certainly true, in hindsight, in *Time*'s case where its board turned down an 80% per-share premium from Paramount only to see *Time*'s stock price gain a paltry 3.5% over the next fourteen years.<sup>191</sup> *Airgas*'s stock price, however, "has remained above the offer price, and, in fact,

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doing so bears some connection to long-term stockholder wealth. Yosifon, *supra* note 169, at 188–93, 198–202. The *Unocal* court said as much on the same page as its famous "constituency" quote. *Unocal*, 493 A.2d at 955 ("[C]orporate directors have a fiduciary duty to act in the best interests of the corporation's stockholders."); *see id.* at 955–56, 956 n.11 (stating that a board need not accede to the desire of short-term shareholders whose interests may be averse to those holding for the long term). The *Shlensky* court did not intervene when the Chicago Cubs' owner refused to install lights in Wrigley Field because "baseball is a daytime sport and . . . the installation of lights and night baseball games [would] have a deteriorating effect upon the surrounding neighborhood." *Shlensky*, 237 N.E.2d at 778 (internal quotation marks omitted). Yet the court recognized that such seemingly non-shareholder-serving actions were actually investments in long-term business reputation and health, wholly consistent with maximizing shareholder wealth. *Id.* at 780–81.

189. N. Am. Catholic Edu. Programming Found. v. Gheewalla, 930 A.2d 92, 101 (Del. 2007) (citing *Malone v. Brincat*, 722 A.2d 5, 9 (Del. 1998)); *Unocal*, 493 A.2d at 955 (citing *Guth v. Loft, Inc.*, 5 A.2d 503, 510 (Del. 1939)); *accord In re Trados Inc. S'holder Litig.*, 73 A.3d 17, 37 (Del. Ch. 2013) ("[T]he standard of conduct . . . mandates that directors maximize the value of the corporation over the long-term for the benefit of the providers of equity capital, as warranted for an entity with perpetual life in which the residual claimants have locked in their investment."); *Blasius Indus. v. Atlas Corp.*, 564 A.2d 651, 663 (Del. Ch. 1988) ("The theory of our corporation law confers power upon directors as the agents of the shareholders; it does not create Platonic masters."); *Katz v. Oak Indus.*, 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 . . ."); *see also* *Quadrant Structured Prods. Co. v. Vertin*, 115 A.3d 535, 546–47, 547 nn.13 & 18, 548 n.19, 551 (Del. Ch. 2015) (interpreting *Gheewalla* to require directors to maximize corporate value for the firm's residual claimants, which are ordinarily stockholders, but may be creditors if the firm is insolvent). *But see* *Williams*, *supra* note 155 ("[T]he law—at least as decided by the Delaware Supreme Court—does not yet clearly articulate shareholder wealth maximizing as the standard of conduct in order for boards to meet their fiduciary obligations . . ."). Whether, when, and to what extent other entities may be classified as residual risk bearers is a topic left for a future work.

190. *Williams*, *supra* note 155.

191. Steven Rattner, *Merge at Your Own Risk*, WALL ST. J., July 30, 2003, at A13.

has increased nearly 50% [as of 2014].”<sup>192</sup> As of August 2015, Airgas stock was trading at a 70% premium over the \$70 offer price of December 2009.<sup>193</sup> In May 2016, Airgas was acquired for \$143 per share.<sup>194</sup>

In the short run, the BJR demands only loose adherence to shareholder wealth maximization.<sup>195</sup> Where there is no inevitable sale of the company, or transfer of control that would subject shareholders to the risks borne by holders of minority shares, managers may forego short-run gains in exchange for greater long-term ones.<sup>196</sup> This is a sensible default rule given the value-destroying potential of short-termism,<sup>197</sup> despite potentially legitimate disagreement over whether selling or holding would in fact create more expected present value.<sup>198</sup>

At the “*Revlon* moment,” which occurs either when a company is certain to be sold, or when a transaction causes control to shift from a diffuse set of shareholders to a concentrated block, managers must maximize the short-term *expected* value<sup>199</sup> realized by shareholders.<sup>200</sup> Courts mandate short-term shareholder wealth maximization in these situations because they are the last opportunities for shareholders to fully realize their returns on their investments or for minority

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192. Edward B. Rock, *Institutional Investors in Corporate Governance*, 21 U. Pa. L. Sch. Inst. L. & Econ., Research Paper No. 14-37 (alteration in original).

193. *Airgas*, 16 A.3d at 66; BLOOMBERG FIN. L.P., BLOOMBERG LAW COMPANY REPORT: AIRGAS, INC. 4 (2015) (custom report of Aug. 11, 2015 on file with author).

194. *Air Liquide completes acquisition of Airgas*, AIR LIQUIDE, <http://www.airliquide.com/media/air-liquide-completes-acquisition-airgas> (last visited Nov. 2, 2016).

195. *See also supra* note 161 and accompanying text (citing sources relying on this fact as evidence against a wealth-maximization fiduciary duty).

196. *Revlon, Inc. v. MacAndrews & Forbes Holdings*, 506 A.2d 173, 176, 182 (Del. 1986); *Paramount Commc'ns v. QVC Network*, 637 A.2d 34, 42–45 (Del. 1993); *see also Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985); *supra* note 169.

197. *See infra* notes 349–357 and accompanying text.

198. Some corporations are properly formed as short-term enterprises. *See infra* notes 359–360 and accompanying text.

199. Boards can consider factors other than merely price, including an offer's feasibility, financing, legality, risk of nonconsummation, and the bidder's identity and business experience. *QVC Network*, 637 A.2d at 44.

200. *Id.* at 46–47; *Revlon*, 506 A.2d at 184. As this Part shows, and contrary to popular claim, *e.g.*, Williams, *supra* note 187; STOUT, *supra* note 1, at 30–31, it is not only at the *Revlon* moment that shareholder wealth is the proper endgame. Indeed, it would be arbitrary for a strict shareholder-wealth-maximization rule to come into play at the end of the firm's life, but not at any time before. *See also infra* text accompanying and following note 226.

shareholders to be paid for their control premiums.<sup>201</sup> Shareholder interests have also been aligned because there is no longer a divergence between those who would like to sell and those who would like to hold. The short run has caught up to the long run.<sup>202</sup> At this point, the board of directors' single-minded goal must be maximizing value obtained for shareholders' stock. It may only collaterally—essentially accidentally—protect nonshareholder interests if those interests create equivalent or greater value for shareholders.<sup>203</sup> In sum, although directors “enjoy a remarkably wide range of autonomy in deciding what to do with the corporation's earnings and assets,” long-term shareholder goals—assumed to be, but not logically confined to, shareholder value—cabin their discretion.<sup>204</sup>

## 2. “The corporation and its shareholders”

Neither, as some assert, has the common law disclaimed shareholder wealth maximization by describing directors' duties as

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201. Vice Chancellor Laster disagrees, arguing that the possible future loss of a control premium will be capitalized into current stock price. See Laster, *Revlon*, *supra* note 81, at 37–47. This depends on very accurate knowledge about the future, and in any event, would be reflected in the stock price as an expected value. When the change in control actually happens, the full value of the premium is lost.

Similarly, some scholars reject the notion that long-term shareholder wealth maximization is different from the short term, on the ground that short-term share price is always an accurate measure of today's best estimate of future value creation. Blair & Stout, *supra* note 11, at 304. But see STOUT, *supra* note 1, at 63–65. But the majority of Efficient Capital Market Hypothesis proponents (including one of its founders, Professor Eugene Fama) acknowledge that only the semi-strong form of the ECMH is a valid model of share prices, and that even this version is imperfect. Clifford Asness & John Liew, *The Great Divide over Market Efficiency*, INST. INV. (Mar. 3, 2014), <http://www.institutionalinvestor.com/Article/3315202/Asset-Management-Equities/The-Great-Divide-over-Market-Efficiency.html#WAcCZJMrI5s>; Lynn A. Stout, *Are Stock Markets Costly Casinos? Disagreement, Market Failure, and Securities Regulation*, 81 VA. L. REV. 611, 646–56 (1995).

202. *TW Servs., Inc. v. SWT Acquisition Corp.*, CIV. A. Nos. 10427, 10298, 1989 WL 20290, at \*6 (Del. Ch. Mar. 2, 1989) (“In such a setting, for the present shareholders, there is no long run.”) (unpublished).

203. *Revlon*, 506 A.2d at 185. *Revlon* is thus a subcategory of *Unocal* in which boards must focus directly on maximizing the price obtained by shareholders, considering other constituencies whose rights are “fixed by contract” only collaterally. *Id.* at 182. *Revlon* stated that it was applying *Unocal*. *Id.* at 176, 180–82, 184. Under *Unocal*, by contrast, boards must maximize long-term value, and they may do so via the well-being of other constituencies *or*, if the present value of selling is greater than that which may be generated by continuing to operate, by maximizing immediate sale price. See *supra* notes 169, 188.

204. STOUT, *supra* note 1, at 31; *cf. supra* text accompanying note 161.



flowing to *both* “the corporation and its shareholders.”<sup>205</sup> This phrase was made famous in the Delaware Supreme Court case of *Guth v. Loft*,<sup>206</sup> and has been cited by many opinions since, including *Revlon* and *Unocal*. But nearly all agree that *Revlon* requires a stringent form of shareholder wealth maximization. And *Unocal* cited *Guth* for its proposition that “corporate directors have a fiduciary duty to act in the best interests of the corporation’s stockholders.”<sup>207</sup>

*Guth* was a corporate opportunity case in which Loft, Inc., accused its Vice President, Guth, of usurping a corporate opportunity of Loft’s for the benefit of a firm owned by him and his family.<sup>208</sup> The injury allegedly caused by Guth was directly to the corporation, with other constituencies impacted only indirectly, if at all. By nonetheless including shareholders—and no other constituency—as beneficiaries of the board’s fiduciary duties, the court showed that it considered harm directly to Loft, Inc., as synonymous with harm to Loft’s shareholder residual claimants, who formed the corporation with *their* ends in mind.<sup>209</sup> *Revlon*’s and *Unocal*’s reference to the corporation—when the issue was harm caused directly to shareholders denied a fair price for their stock—likewise supports this equivalency between shareholders and the corporation.<sup>210</sup> As Vice Chancellor J. Travis Laster said, “This formulation captures the intuition that directors owe duties to the corporation for the ultimate benefit of the residual claimants.”<sup>211</sup> Much of this intuition applies to the assessment of nonshareholder constituency statutes, discussed next.

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205. *E.g.*, Johnson & Millon, *supra* note 123 at 13 (citing Loft, Inc. v. Guth, 2 A.2d 225, 238 (Del. Ch. 1938), *aff’d sub nom.* Guth v. Loft, Inc., 5 A.2d 503 (Del. 1939)); Millon, *supra* note 161, at 1031 (same); Blair & Stout, *supra* note 11, at 293 n.105 (citing Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1280 (Del. 1988)); Williams, *supra* note 187 (citing *Unocal*, 493 A.2d at 952, 954–55).

206. *Guth*, 5 A.2d at 510, *aff’g* Loft, 2 A.2d 225.

207. *Revlon*, 506 A.2d at 179; *Unocal*, 493 A.2d at 955; *see supra* notes 200, 205.

208. *Guth*, 5 A.2d at 505–06, 510.

209. *See also* Yosifon, *supra* note 169, at 208–13 (noting that the phrase mentions only the shareholder constituency).

210. *Revlon*, 506 A.2d at 179; *Unocal*, 493 A.2d at 953.

211. Laster, *Revlon*, *supra* note 81, at 28; *see* Quadrant Structured Prods. Co. v. Vertin, 115 A.3d 535, 546–47, 547 nn.13 & 18, 548 n.19 (Del. Ch. 2015) (Laster, Vice Chancellor) (directors “owe fiduciary duties to the corporation for the benefit of all of its residual claimants”).

*D. Claim #4: Nonshareholder Constituency Statutes Have Invalidated the Shareholder Wealth Maximization Norm*

Another argument against the shareholder wealth maximization norm is that a majority<sup>212</sup> of states (not including Delaware) have enacted nonshareholder constituency statutes that allow boards to consider the interests of nonshareholders.<sup>213</sup> One view is that these statutes allow boards to serve nonshareholders without connecting their acts to shareholder interests. A more moderate view is that the statutes reaffirm that corporate boards may in fact pursue nonshareholder interests purposively or collaterally in their ultimate

212. Sources differ on how many states have enacted such statutes. Compare, e.g., Kathryn Acello, *Having Your Cake and Eating It, Too: Making the Benefit Corporation Work in Massachusetts*, 47 SUFFOLK U. L. REV. 91, 100 & n.51 (referring to thirty-three statutes and citing thirty-one) with Lyman Johnson & Prof. David K. Millon, *Corporate Law After Hobby Lobby* 19 (Wash. & Lee Pub. Legal Stud. Res. Paper Series, Accepted Paper No. 2014-19, Oct. 8, 2014) (counting forty-one statutes in this prepublication version of Johnson & Millon, *supra* note 123).

This Article considers twenty-nine statutes to qualify because they refer to nonshareholder interests: CONN. GEN. STAT. ANN. § 33-756(d) (West 2015); FLA. STAT. ANN. § 607.0830(3) (West 2016); GA. CODE ANN. § 14-2-202(b)(5) (2003); HAW. REV. STAT. ANN. § 414-221(b) (2004); IDAHO CODE § 30-1602 (2013); 805 ILL. COMP. STAT. ANN. 5/8.85 (West 2015); IND. CODE ANN. § 23-1-35-1(d) (LexisNexis 2010); IOWA CODE ANN. § 490.1108A(1) (West 2009); KY. REV. STAT. ANN. § 271B.12-210(4) (LexisNexis 2012); ME. REV. STAT. ANN. tit. 13-C, § 831(6) (2007); MD. CODE ANN., CORPS. & ASS'NS § 2-104(b)(9) (LexisNexis 2014); MASS. GEN. LAWS ANN. ch. 156D, § 8.30(a)(3) (West 2005); MINN. STAT. ANN. § 302A.251(5) (West 2011); MO. ANN. STAT. § 351.347(1) (West 2015); NEV. REV. STAT. ANN. § 78.138(4) (2015); N.J. STAT. ANN. § 14A:6-1(2) (West 2003); N.M. STAT. ANN., § 53-11-35(D) (LexisNexis 2004); N.Y. BUS. CORP. LAW § 717(b) (LexisNexis 2003); N.D. CENT. CODE ANN. § 10-19.1-50(6) (West 2012); OHIO REV. CODE ANN. § 1701.59(F) (LexisNexis 2015); OR. REV. STAT. § 60.357(5) (2015); 15 PA. STAT. AND CONS. STAT. ANN. § 1715(a)(1) (West 2013); 7 R.I. GEN. LAWS § 7-5.2-8(a) (1999); S.D. CODIFIED LAWS § 47-33-4 (2007); TENN. CODE ANN. § 48-103-204 (2012); VT. STAT. ANN. tit. 11A, § 8.30(a) (2010); WIS. STAT. ANN. § 180.0827 (West 2016); WYO. STAT. ANN. § 17-16-830(g) (2015). Other statutes, like ARIZ. REV. STAT. ANN. 10-2702 (2013) and VA. CODE ANN. § 13.1-727.1 (2011), state only that a corporate board may, in the takeover context, determine that the interests of “the corporation” or “the corporation and its shareholders,” respectively, “may be best served by the continued independence of the corporation.” But the board must *always* decide whether to accept, reject, or ignore a bid. See *supra* text accompanying notes 164, 168–170. Virginia’s statute codified the common law by explicitly requiring directors to consider shareholder interests, even if corporate and shareholder interests are not seen as coincident. See *supra* Section II.C.2.

213. E.g., Johnson & Millon, *supra* note 123, at 14; see Lawrence E. Mitchell, *A Theoretical and Practical Framework for Enforcing Corporate Constituency Statutes*, 70 TEX. L. REV. 579 (1992).

pursuit of long-term shareholder wealth.<sup>214</sup> Another possibility—explicitly stated by three constituency statutes and fitting this Article’s approach to corporate purpose—is that the statutes allow (but do not require) shareholders to include non-shareholder-oriented purposes in corporate articles.<sup>215</sup> B Lab, the nonprofit organization that has been labeling firms meeting its prosocial criteria as “Certified B Corporations” since 2007, apparently adopts this view.<sup>216</sup>

The statutes appear, with some exceptions around the edges and one caveat, to line up rather consistently behind allowing corporate boards to consider nonshareholder interests provided that long-term shareholder wealth is the ultimate goal. All make considering nonshareholder interests optional in any given situation.<sup>217</sup> At least six (21%),<sup>218</sup> and as many as thirteen (45%),<sup>219</sup> require directors to

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214. *See supra* Section II.C.1. The narrowest view is that the statutes codify a version of the business judgment rule under which boards may consider nonshareholder interests only to maximize today’s stock price. If this were the correct interpretation, there would be no need to pass the statutes in the first instance.

215. GA. CODE ANN. § 14-2-202(b)(5) (2003); MD. CODE ANN., CORPS. & ASS’NS § 2-104(b)(9) (LexisNexis 2014); TENN. CODE ANN. § 48-103-204 (2012). An interesting variation on this scenario is that the state chartering agency might include in the certificate of incorporation purposes unrelated to shareholders as a condition of chartering the corporation. *See supra* note 46. (An alternate method for specifying conditions would, of course, be needed in states with unitary charters. *See supra* note 48.) This possibility would be most relevant to corporations otherwise formed to pursue nonmonetary private benefits for their shareholders. *See infra* Section III.B.4.

216. *Corporation Legal Roadmap*, B LAB, <http://www.bcorporation.net/become-a-b-corp/how-to-become-a-b-corp/legal-roadmap/corporation-legal-roadmap> (last visited Sept. 8, 2016) (stating that firms incorporated in states with constituency statutes can serve nonshareholder interests by including an appropriate charter provision, but that the best that firms incorporated in other states can do is write up a “Term Sheet [that] commits [the] company to consider stakeholders to the extent possible within the current corporate laws of [its] state”).

217. None of the statutes require boards to consider nonshareholder interests. *See supra* note 212 (citing statutes). In the process, the statutes ensure that no nonshareholders get the benefit of board fiduciary duties. Some are explicit in this. GA. CODE ANN. § 14-2-202(b)(5) (2003); NEV. REV. STAT. § 78.138(6) (2015); N.Y. BUS. CORP. LAW § 717(b) (LexisNexis 2003).

218. HAW. REV. STAT. ANN. § 414-221(b) (2004); IDAHO CODE § 30-1602 (2013); MISS. CODE ANN. § 79-4-8.30(f) (2013); N.M. STAT. ANN. § 53-11-35(D) (LexisNexis 2004); OHIO REV. CODE ANN. § 1701.59(F) (LexisNexis 2015); WYO. STAT. ANN. § 17-16-830(g) (2015).

219. IOWA CODE ANN. § 490.1108A(1) (West 2009); KY. REV. STAT. ANN. § 271B.12-210(4) (LexisNexis 2012); ME. REV. STAT. ANN. tit. 13-C, § 831(6) (2007); N.J. STAT. ANN. § 14A:6-1(2) (West 2003); 7 R.I. GEN. LAWS § 7-5.2-8(a) (1999); S.D. CODIFIED LAWS § 47-33-4 (2007); WIS. STAT. ANN. § 180.0827 (West 2016). These statutes employ language which can be understood either to require boards to consider shareholder interests while allowing them to consider nonshareholder ones, or to make consideration of all constituent interests optional.

consider shareholder interests; only two (7%) state that boards need not consider any particular constituency's interests.<sup>220</sup> Twenty-one (72%) of the statutes explicitly state that directors may consider the company's long-term prospects when discharging their duties.<sup>221</sup> Nine (31%) of the statutes explicitly apply only in the takeover context,<sup>222</sup> and another fourteen (48%) imply as much by referring to the corporation's continued independence.<sup>223</sup>

The sparse case law on the matter supports this interpretation by following the *Unocal* rule,<sup>224</sup> but adds the caveat that the statutes generally appear to abrogate the *Revlon* subspecies of *Unocal* by allowing boards to consider nonshareholder interests even when shareholders will not have a later opportunity to monetize their

Given the strong history of the shareholder wealth maximization norm, the former is more reasonable.

220. IND. CODE ANN § 23-1-35-1(d) (LexisNexis 2010); 15 PA. STAT. AND CONS. STAT. ANN. § 1715(a)(1) (West 2013).

221. CONN. GEN. STAT. ANN. § 33-756(d) (West 2015); FLA. STAT. ANN. § 607.0830(3) (West 2016); HAW. REV. STAT. ANN. § 414-221(b) (2004); IND. CODE ANN § 23-1-35-1(d) (LexisNexis 2010); IOWA CODE ANN. § 490.1108A(1) (West 2009); KY. REV. STAT. ANN. § 271B.12-210(4) (LexisNexis 2012); MASS. GEN. LAWS ANN. ch. 156D, § 8.30(a)(3) (West 2005); MINN. STAT. ANN. § 302A.251(5) (West 2011); MISS. CODE. ANN. § 79-4-8.30(f) (2013); NEV. REV. STAT. ANN. § 78.138(4) (2015); N.J. STAT. ANN. § 14A:6-1(2) (West 2003); N.M. STAT. ANN. § 53-11-35(D) (LexisNexis 2004); N.Y. BUS. CORP. LAW § 717(b) (LexisNexis 2003); N.D. CENT. CODE ANN. § 10-19.1-50(6) (West 2012); OHIO REV. CODE ANN. § 1701.59(F) (LexisNexis 2015); OR. REV. STAT. § 60.357(5) (2015); 15 PA. STAT. AND CONS. STAT. ANN. § 1715(a)(1) (West 2013); 7 R.I. GEN. LAWS § 7-5.2-8(a) (1999); S.D. CODIFIED LAWS § 47-33-4 (2007); VT. STAT. ANN. tit. 11A, § 8.30(a) (2010); WYO. STAT. ANN. § 17-16-830(g) (2015).

222. CONN. GEN. STAT. ANN. § 33-756(d) (West 2015); IOWA CODE ANN. § 490.1108A(1) (West 2009); KY. REV. STAT. ANN. § 271B.12-210(4) (LexisNexis 2012); MD. CODE ANN., CORPS. & ASS'NS § 2-104(b)(9) (LexisNexis 2014); MO. ANN. STAT. § 351.347(1) (West 2015); OR. REV. STAT. § 60.357(5) (2015); 7 R.I. GEN. LAWS § 7-5.2-8(a) (1999); S.D. CODIFIED LAWS § 47-33-4 (2007); TENN. CODE ANN. § 48-103-204 (2012). Takeovers were often seen as value-destroying when most constituency statutes were passed.

223. HAW. REV. STAT. ANN. § 414-221(b) (2004); IDAHO CODE § 30-1602 (2013); 805 ILL. COMP. STAT. ANN. 5/8.85 (West 2015); MINN. STAT. ANN. § 302A.251(5) (West 2011); MISS. CODE. ANN. § 79-4-8.30(f) (2013); NEV. REV. STAT. § 78.138(4) (2015); N.J. STAT. ANN. § 14A:6-1(2) (West 2003); N.M. STAT. ANN. § 53-11-35(D) (LexisNexis 2004); N.Y. BUS. CORP. LAW § 717(b) (LexisNexis 2003); N.D. CENT. CODE ANN. § 10-19.1-50(6) (West 2012); OHIO REV. CODE ANN. § 1701.59(F) (LexisNexis 2015); 15 PA. STAT. AND CONS. STAT. ANN. § 1715(a)(1) (West 2013); VT. STAT. ANN. tit. 11A, § 8.30(a) (2010); WYO. STAT. ANN. § 17-16-830(g) (2015).

224. See *supra* notes 169–170 and accompanying text.

investments.<sup>225</sup> Although certainly a weakening at one corner of the shareholder wealth maximization norm, *Revlon* situations are rare. The statutes can also be seen as legislatures weighing a need to ensure, at the last period, that nonshareholders get the benefits of their implicit and explicit contracts with firms<sup>226</sup> against a need to ensure that shareholders get the benefits of their bargains with their boards. Inasmuch as stockholders, to protect their interests, yield power to boards to allow boards credibly to commit to fulfilling their contractual obligations, such weakening of *Revlon* is consistent with shareholder wealth maximization. Given the paucity of decisions on constituency statutes outside the *Unocal/Revlon* context, it is reckless to deem abrogated long-standing common law protecting stockholder ends.

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225. *Gut v. MacDonough*, No. Civ.A.2007-1083-C., 2007 WL 2410131, at \*8–9 (Mass. Super. Aug. 14, 2007) (unpublished); *see also* *Basswood Partners, L.P. v. NSS Bancorp, Inc.*, No. CV9801634128, 1998 WL 59476, at \*3 (Conn. Super. Ct. Feb. 6, 1998) (holding that Connecticut’s constituency does not prevent shareholders seeking corporate records to pursue their ends) (unpublished). These two cases comprise *all* the decisions by courts of the states that passed the respective statute. Non-home-state courts tend to agree, but their decisions, of course, are not binding. *Kloha v. Duda*, 246 F. Supp. 2d 1237 (M.D. Fla. 2003); *Dixon v. Ladish Co.*, 785 F. Supp. 2d 746, 753 (E.D. Wis. 2011); *Shepard v. Meridian Ins. Grp., Inc.*, 137 F. Supp. 2d 1096, 1113 (S.D. Ind. 2001); *Hilton Hotels Corp. v. ITT Corp.*, 978 F. Supp. 1342, 1346 (D. Nev. 1997); *Gelco Corp. v. Coniston Partners*, 652 F. Supp. 829, 845 (D. Minn. 1986); *First Union Corp. v. Suntrust Banks, Inc.*, No. 01-CVS-10075, 01-CVS-8036, CIV. A. 01-CVS-4486, 2001 WL 1885686, at \*5 (N.C. Super. Ct. Aug. 10, 2001) (concluding that Illinois’s statute abrogated *Revlon*); *see also* *Dugan v. Towers, Perrin, Forster & Crosby, Inc.*, No. 2:09-cv-5099, 2012 WL 6194211, at \*13 (E.D. Pa. Dec. 11, 2012) (holding that Pennsylvania’s statute does not create a cause of action against directors) (unpublished); *Flake v. Hoskins*, 55 F. Supp. 2d 1196 (D. Kan. 1999) (concluding that *Revlon* does not conflict with Missouri’s statute); *Safety-Kleen Corp. v. Laidlaw Envtl. Servs., Inc.*, No. 97 C 8003, 1999 WL 601039, at \*12–13 (N.D. Ill. Feb. 4, 1998) (concluding that Wisconsin’s statute abrogated *Revlon*) (unpublished). *But see* *Nelson v. Ipalco Enters., Inc.*, 480 F. Supp. 2d 1061, 1080 (S.D. Ind. 2007) (appearing to abrogate both *Unocal* and *Revlon*); *Crandon Capital Partners v. Shelk*, 181 P.3d 773, 783 (Or. Ct. App. 2008) (concluding that New Jersey’s statute abrogated both *Revlon* and *Unocal*). Most scholars agree. *See* Bainbridge, *Constituency Statutes*, *supra* note 1, at 991–94, 1015, 1019; James J. Hanks, Jr., *Playing with Fire: Nonshareholder Constituency Statutes in the 1990s*, 21 STETSON L. REV. 97, 107 (1991). An empirical study by Professors Christopher Geczy, Jessica S. Jeffers, David K. Musto, and Anne M. Tucker supports this conclusion. Christopher Geczy et al., *Institutional Investing When Shareholders Are Not Supreme*, 5 HARV. BUS. L. REV. 73, 105–14 (2015).

226. *See* Bainbridge, *Constituency Statutes*, *supra* note 1, at 1004–08; Mitchell, *supra* note 1, at 634–40.

*E. Claim #5: Corporations May Be Formed to Pursue “Any Lawful Purpose”*

A final assertion is that, under Delaware law, a corporation may be organized for “any lawful business or purposes,”<sup>227</sup> and that because most corporate charters merely recite this or a similar phrase, directors of those firms have plenary power to disregard shareholder interests in favor of other legal goals.<sup>228</sup> This evinces a misunderstanding of statutory “purpose” language. Current law does not grant managers free reign to determine—and alter at any given moment—corporate *raison d’être*. This Article does, however, argue for shareholder freedom to charter corporations to pursue nonstandard ends if nonfounding shareholders are adequately noticed.

*1. The common law makes ignoring shareholder interests unlawful*

As an initial matter, this claim circularly implies that corporate charters can define what is lawful. Shareholder wealth maximization is a common-law rule,<sup>229</sup> and corporate-law statutes are typically silent on the matter save in the cabined contexts of constituency statutes<sup>230</sup> and special corporation types, like benefit or nonprofit corporations.<sup>231</sup> Under their common-law fiduciary duties, it is by default unlawful for managers not to attempt to maximize shareholder wealth.<sup>232</sup>

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227. DEL. CODE ANN. tit. 8, § 101(b) (2011) (“A corporation may be incorporated or organized under this chapter to conduct or promote any lawful business or purposes, except as may otherwise be provided by the Constitution *or other law* of this State.”) (emphasis added); *id.* §102(a)(3) (“It shall be sufficient to state [in the certificate of incorporation], either alone or with other businesses or purposes, that the purpose of the corporation is to engage in any lawful act or activity for which corporations may be organized under the General Corporation Law of Delaware, and by such statement all lawful acts and activities shall be within the purposes of the corporation . . .”).

228. *E.g.*, STOUT, *supra* note 1, at 28, 32 (“Directors and executives can run corporations to maximize shareholder value, but unless the corporate charter provides otherwise, they are free to pursue any other lawful purpose as well. Maximizing shareholder value is not a managerial obligation, it is a managerial choice.”); Johnson & Millon, *supra* note 123, at 8–10, 13–14, 30 (“[T]he board is free to advance the corporation’s mixed objectives over the objections of shareholders and at the expense of strict shareholder primacy.”) Other states have similar provisions.

229. *See supra* Sections II.A–C.

230. *See supra* Section II.D.

231. *See infra* Section III.C.1; note 241.

232. *See supra* Section II.B.1.

Shareholders may, via charter, only alter a common-law rule if they steer clear of “a result forbidden by settled rules of public policy.”<sup>233</sup>

This test is easily failed by a panoptic view of modern purpose language: it is unreasonable and unfair to assume that shareholders—most of whom invest for profit<sup>234</sup>—would, by specifying “any lawful purpose,” enable their boards to further any end desired by managers at any given moment. It would compound the inequity to presume that shareholders effectively waive their fiduciary rights given their bargained-for inability to undo management actions.<sup>235</sup> More affirmative relinquishment of the wealth-maximization stick is needed to avoid injustice to equity investors.

## 2. *Tactical versus strategic purpose*

Despite managers’ inability to alter corporate ends, shareholders should be able to grant their boards authority to pursue nonwealth ends. Disaggregating the concept of corporate purpose into its “tactical” and “strategic” purposes clarifies both to what corporation-law statutes typically refer when they speak of “purpose,” and the spheres in which managers have and lack sovereignty.

A tactical, or operating, purpose is a firm’s allowable sphere of business, like selling insurance,<sup>236</sup> brewing beer,<sup>237</sup> operating a railroad,<sup>238</sup> or making musical instruments.<sup>239</sup> Tactical purposes were once part of the basis for cabining a firm’s activities and liability via the mostly abolished *ultra vires* doctrine.<sup>240</sup> A corporation engages in

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233. *Sterling v. Mayflower Hotel Corp.*, 93 A.2d 107, 117–18 (Del. 1952).

234. *See supra* note 83 and accompanying text.

235. *See supra* Section II.B.2–3; *see also* Bainbridge, *supra* note 1, at 1442–45 & nn.70–71; Johnson & Millon, *supra* note 123, at 27–28.

236. *See infra* notes 246–250 and accompanying text.

237. *See infra* note 250.

238. *See infra* text accompanying note 250.

239. *See infra* note 252 and accompanying text.

240. The *ultra vires* doctrine held that activities that were not authorized by the corporate charter were void as a matter of law. This meant that (1) third parties contracting with a corporation on *ultra vires* matters could not enforce their contracts, and (2) that shareholders could prevent *ultra vires* corporate acts despite a board vote to the contrary. The harsh consequences for third parties led to the abolition of this first aspect of the doctrine. DEL. CODE ANN. tit. 8, § 124 (2011). Shareholders may, however, continue to derivatively or directly challenge charter violations. *Id.* § 124(2); *Carsanaro v. Bloodhound Techs., Inc.*, 65 A.3d 618, 647–54 (Del. Ch. 2013). This Article does not propose altering this balance in the *ultra vires* doctrine.

permitted operations in pursuit of its strategic purpose—the ultimate end of the corporation, of which shareholder wealth maximization is the archetypical example.

Most corporate law statutes that authorize “any lawful purpose” should be seen as referring to tactical purposes.<sup>241</sup> Although most states’ statutes allowed the formation of corporations for any lawful purpose since the early 1900s,<sup>242</sup> those statutes required each charter to specify a given firm’s purposes in specific terms.<sup>243</sup> It was only much later that states began allowing corporations to be *chartered* with multi-purpose language authorizing the firms to pursue any lawful purpose. Delaware, for example, amended its statute to include multi-purpose language in 1967, before which formal purpose recitations were required.<sup>244</sup> Its legislature presumably switched to the “any lawful purpose” language to enable firms to make value-enhancing tactical decisions, like taking advantage of synergies in expanding or adapting to market conditions, without having to engage in the guessing game of making “extensive recitals of all the conceivable types of business in which the corporation could engage.”<sup>245</sup>

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Corporate “powers,” which resemble tactical purposes, were another basis for cabining a firm’s activities. Courts applying the *ultra vires* doctrine often meshed the concepts. *See infra* note 253.

241. This Article asserts that this is the proper way to view most corporation-law statutes, including title 8, section 101(c) combined with section 102(a)(3) of the Delaware Code, DEL. CODE ANN. (Supp. 2015). *See supra* note 227; *infra* notes 242–244 and accompanying text. Delaware, however, has recently complicated things by using “purpose” to refer, in the benefit-corporation context, to “one or more specific public benefits.” § 362(a)(1). That benefit corporations, which must be formed to pursue multiple ends, were explicitly added to the Delaware General Corporation Law as a separate entity type, suggests that general business corporations cannot pursue any end chosen by managers at any given moment. *Id.* There would be no need for a new entity type if traditional corporations could be formed to pursue any combination of ends.

242. Joel Seligman, *A Brief History of Delaware’s General Corporation Law of 1899*, 1 DEL. J. CORP. L. 249, 269 (1976).

243. *E.g.*, 21 DEL. LAWS ch. 273, § 7 (1899).

244. EDWARD P. WELCH ET AL., 1 FOLK ON THE DELAWARE GENERAL CORPORATION LAW § 102.4 (5th ed. 2006). *Compare* DEL. CODE ANN. tit. 8, § 102(a)(3) (Delaware’s current statute allowing a certificate provision stating that “all lawful acts and activities shall be within the purposes of the corporation”) *with* 21 DEL. LAWS ch. 273, § 7 (1899) (previous statute requiring a certificate provision specifying “[t]he nature of the business or objects or purposes proposed to be transacted, promoted or carried on.”).

245. WELCH ET AL., *supra* note 244, at § 102.4. Note that the commentator equates a purpose with a type of business in which the firm may engage. TransUnion, for example, began in 1968 as a railcar-leasing company. *Company History*, TRANSUNION,



A few sample cases involving typical tactical purposes show that “purpose,” as used in corporate charters and statutes, refers to allowable firm operations. In *People ex rel. Perkins v. Moss*, Perkins, officer of an insurance company involved in the Great Wall Street Scandal, challenged his criminal indictment for making a nearly \$50,000 political contribution from corporate funds.<sup>246</sup> Although split on the criminality question,<sup>247</sup> and despite Perkins’ insistence that he made the donation to promote policyholder interests and “had acted in the honest belief that he was benefiting the company,” the court unanimously agreed that the donation was *ultra vires* because not authorized by its charter.<sup>248</sup> A company tactically purposed with writing insurance, in other words, could not pursue its strategic purpose—assumed to be serving stockholder interests<sup>249</sup>—by making campaign contributions. Had the charter authorized political activity, the donation would presumably have been legitimate, as long as it was made ultimately to benefit shareholders.<sup>250</sup>

*Brinson Ry. Co. v. Exchange Bank of Springfield*, in holding that a railroad corporation’s attempting to build a school in a town on its line was *ultra vires*, succinctly stated the concept of tactical corporate purpose by referring to the operations in which a corporation may engage: “Every corporation must act according to its nature: a trading

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<http://www.transunion.com/corporate/about-transunion/who-we-are/company-history.page> (last visited Sept. 8, 2016). It acquired a credit agency to complement some of its technology investments. *Id.* Its railcar-leasing business subsequently declined, and it is now one of the three primary credit-reporting firms. TransUnion is the subject of the famous case, *Smith v. Van Gorkum*, 488 A.2d 858 (Del. 1985).

246. *People ex rel. Perkins v. Moss*, 80 N.E. 383, 383, 391 (N.Y. 1907); see *supra* text accompanying notes 136–150.

247. New York’s high court ruled that criminal charges could not stand because the matter was “private in its character and must be redressed by private suit.” *Perkins*, 80 N.E. at 386.

248. *Id.* at 386–87 (“The company had not the right, under the law of its existence, to agree to make contributions for political campaigns, any more than to agree to do other things foreign to its charter”); *id.* at 388 (Hiscock, J., concurring) (stating that the contribution “was absolutely beyond the purposes for which that corporation existed”); see *id.* at 392 (Cullen, C.J., dissenting) (describing Perkins’s actions as both *ultra vires* and criminal).

249. See *supra* text accompanying notes 136–150.

250. Cf. SEYMOUR D. THOMPSON, 3 COMMENTARIES ON THE LAW OF PRIVATE CORPORATIONS § 2819 (2d ed. 1909) (discussing the problems with *ultra vires* political donations); *People v. Gansley*, 158 N.W. 195, 201 (Mich. 1916) (holding that a firm chartered for the “purpose of manufacturing beer” could not make a \$500 political contribution because “[t]he privilege was not conferred upon it of using its funds for the purpose of influencing public sentiment in connection with any election”).

corporation must trade, a manufacturing corporation must manufacture, a banking corporation must bank, a transportation corporation must carry, etc.”<sup>251</sup>

Not all courts were so restrictive. *Virgil v. Virgil Practice Clavier Co.* and *Steinway v. Steinway & Sons* allowed firms chartered to make and sell musical instruments to open music schools and donate pianos to charity on the ground that they were directly related to the firms’ purposes.<sup>252</sup>

These typical purposes were all tactical—they prescribed the business operations in which the firms could engage while pursuing their strategic purposes.<sup>253</sup> They were restrictive by nature. The 1967 “any lawful purpose” language lifted this restriction in firms that opted into it. There is no reason to believe that in making it easier to engage in any lawful operations, the Delaware legislature intended to arrogate shareholder wealth maximization as the general business corporation’s default (or mandatory<sup>254</sup>) strategic purpose.<sup>255</sup>

Courts allow managers of firms chartered to conduct “any lawful purpose” to pursue any lawful tactical purpose, including the interests of nonshareholder constituencies or donating to political candidates,

251. *Brinson Ry. Co. v. Exch. Bank of Springfield*, 85 S.E. 634, 634–35 (Ga. 1915).

252. *Virgil v. Virgil Prac. Clavier Co.*, 68 N.Y.S. 335, 335–36 (Sup. Ct. 1900) (“[M]anufacturing corporation organized . . . for ‘the manufacture and sale of instruments designed for practice and instruction in the art of playing the piano and other instruments having a similar keyboard, and of any instrument, appliance, or thing which may be used for such practice and instruction, whether independently or in connection with musical instruments or with instruments designed for practice only.’”); *Steinway v. Steinway & Sons*, 40 N.Y.S. 718, 718 (Sup. Ct. 1896) (“[T]he company was incorporated . . . for the purpose, as expressed in the certificate of incorporation, of manufacturing and selling pianofortes and other musical instruments.”). In *Steinway*, the plaintiff also challenged more obviously appropriate acts, including the construction of a factory and employee facilities. *Id.* at 719.

253. *Accord* *Yosifon*, *supra* note 169, at 185 n.12. Tactical purposes were similar to corporate powers, and courts often referred to them as such. *See, e.g., Gansley*, 158 N.W. at 200, 201 (referring to beer making as a “purpose”); *Brinson*, 85 S.E. at 634–35; *Perkins*, 80 N.E. at 422; *Virgil*, 68 N.Y.S. at 337; *Steinway*, 40 N.Y.S. at 720–22; *see also* DEL. CODE ANN. tit. 8, § 122 (2011) (covering corporate powers).

254. *See infra* Section III.A.

255. Specially chartered corporations are not an automatic exception. As Professor Roberta Romano notes, “[t]he chartering of corporations to provide public goods in an earlier era does not indicate that the objective was not shareholder wealth maximization. The rate of return on those investments was not fixed by the state, as it is today for public utilities.” Romano, *supra* note 83, at 1602 n.10.

provided that managers advance the shareholders' strategic purpose.<sup>256</sup> Corporate law, at base, is about curbing incentive problems via fiduciary duties. Unfettered board discretion to alter a strategic purpose in ways unauthorized by shareholders would be a classic such problem.

Given that shareholders are properly assumed to retain the wealth-maximization stick from the corporate bundle,<sup>257</sup> and that statutes are most fairly read to allow any lawful tactical purpose, shareholder wealth maximization is and should be the default strategic purpose in general corporations.<sup>258</sup> This rule fits best with the business and investing community's expectations. A contrary rule would be unfair and disruptive. With this most natural corporate purpose established, if a corporate charter clearly specifies that a corporation is to be strategically run for a non-shareholder value end, courts should enforce it. It is not a given, however, that corporate law allows such flexibility, as discussed in the next Part.

### III. FREEDOM OF CORPORATE PURPOSE

Although the law of corporate purpose has developed in a context where shareholder interests have been synonymous with wealth, it is easily adapted to nonpecuniary concerns. It is often said that individuals will structure their relationships in a way that maximizes their wealth.<sup>259</sup> It is better, however, to say that individuals order their affairs to maximize their well-being.<sup>260</sup> As incomes rise,<sup>261</sup> it is natural that individuals would shift from purely monetary gain to other,

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256. See *Citizens United v. Fed. Election Comm'n* 558 U.S. 310 (2010); *supra* Section II.C. But see *infra* note 269 (discussing federal law).

257. See *supra* notes 80–83 and accompanying text.

258. A firm with charter limits on its tactical purpose would, of course, be limited to engaging in its authorized business operations.

259. *E.g.*, Jeffrey N. Gordon, *The Mandatory Structure of Corporate Law*, 89 COLUM. L. REV. 1549, 1551 n.10 (1989).

260. F.A. HAYEK, *THE ROAD TO SERFDOM: TEXT AND DOCUMENTS* 125–27 (Bruce Caldwell ed. 2007) (1944); Michael C. Jensen & William H. Meckling, *The Nature of Man*, 7 J. APPLIED CORP. FIN. 4 (1994).

261. Chad Stone et al., *A Guide to Statistics on Historical Trends in Income Inequality*, CTR. ON BUDGET AND POL'Y PRIORITIES, (July 29, 2016), <http://www.cbpp.org/research/poverty-and-inequality/a-guide-to-statistics-on-historical-trends-in-income-inequality>.

nonpecuniary preferences.<sup>262</sup> This Part builds on the shareholder wealth maximization norm, proposing that shareholders be allowed to order their affairs as they wish by selecting strategic and tactical purposes of their choosing when they incorporate.

This Part first examines whether existing corporate law is sufficiently enabling to permit diversity in corporate purpose. Concluding that it can be without much alteration, the Article offers an approach stressing stockholder choice. The Part then engages the question of which strategic purposes should be cognizable. It concludes by situating a regime allowing nonwealth purposes amidst alternative off-the-rack corporate forms and addressing concerns related to enforcing shareholder rights.

#### *A. Is Corporate Law Sufficiently Enabling?*

This section examines the distinct lack of clarity in whether the common law of corporate purpose would recognize a chartered nonstandard strategic purpose. It proposes that the doubt be resolved in favor of allowing such purposes, subject to proper shareholder notice. The section concludes with three case studies of firms commonly understood to pursue non-shareholder wealth purposes.

##### *1. Enforceability of nonstandard strategic purposes*

At least one state chartering agency has been unwilling to accept charters with nonstandard purposes. One California attorney working with B Lab and another client in 2010 inquired with the California Secretary of State about the validity under the California Corporations Code of charters containing social purposes.<sup>263</sup> The Secretary's office replied only that it would interpret California's "any lawful act" provision literally.<sup>264</sup> He attempted to file a certificate of incorporation containing the following nonwealth, social purpose on behalf of the client:

Section 1. The purpose of the Corporation is to:

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262. The preferences themselves need not change, but wealth has diminishing marginal utility. As individuals become richer, they will naturally begin to demand more of what is not tied directly to money.

263. Telephone Interview with R. Todd Johnson, Partner, Jones Day (Sept. 2, 2016).

264. *Id.*; CAL. CORP. CODE § 202(b) (West 2015).

(a) Engage in any lawful act or activity for which a corporation may be organized under the General Corporation Law of California other than the banking business, the trust company business, or the practice of a profession permitted to be incorporated by the California Corporations Code; and

(b) Improve the health of young people by developing and/or distributing innovative products and services that will increase physical activity in young people.<sup>265</sup>

The Secretary rejected several attempts.<sup>266</sup>

That same attorney, representing the same client, sought from several Delaware law firms an opinion letter stating that a charter containing a distinctly nonwealth purpose would be enforceable.<sup>267</sup> None would so opine.<sup>268</sup> That is, perhaps, not surprising given how strongly Delaware case law implies that a chartered strategic purpose other than shareholder wealth maximization would be unenforceable.<sup>269</sup> In *eBay Domestic Holdings, Inc. v. Newmark*, for

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265. E-mail from R. Todd Johnson, Partner, Jones Day, to author (Sept. 9, 2016 9:56 AM CDT); [Anonymous], Certificate of Incorporation, June 2010 (on file with author) (The firm's name has been replaced with "Anonymous" to maintain confidentiality.). Although the parties involved interpreted subsection (b) of this provision as a strategic purpose, under this Article's proposal, the charter would ideally make it clear that it intends to displace shareholder wealth, rather than merely achieve shareholder wealth via operations that improve the health of young people by selling innovative products. See *infra* Section III.A.2. The charter would also have to be accompanied by extrinsic notice (which would not likely have been an issue for the proposed corporation) to potential share purchasers that shareholder wealth is not the firm's strategic purpose. *Id.*

266. Telephone Interview with R. Todd Johnson, *supra* note 263; Letter from Theresa Rea-Martinez, Staff Counsel, California Secretary of State Business Programs Division Legal Review to [Anonymous] (June 14, 2010) (on file with author) (The recipient's name has been replaced with "Anonymous" to maintain confidentiality.).

267. Telephone Interview with R. Todd Johnson, *supra* note 263

268. *Id.*

269. As discussed, Delaware is the benchmark for corporate law. See *supra* note 122. Interestingly, federal law after *Burwell v. Hobby Lobby Stores, Inc.*, 134 S. Ct. 2751 (2014), comes down fairly clearly, if implicitly, in support of allowing nonstandard charter provisions. See *id.* at 2770–71; see also *Tyndale House Pubs., Inc. v. Sebelius*, 904 F. Supp. 2d 106, 116 (D.D.C. 2012). Professor Bainbridge maintains that *Hobby Lobby* applies strictly to close corporations. Stephen M. Bainbridge, *Does Hobby Lobby sound a death knell for Dodge v. Ford Motor Co.?*, PROFESSORBAINBRIDGE.COM (July 3, 2014), <http://www.professorbainbridge.com/professorbainbridge.com/2014/07/does-hobby-lobby-sound-a-death-knell-for-dodge-v-ford-motor-co.html>. *Hobby Lobby's* reasoning, however, applies with equal force to public corporations provided that mid-stream investors are aware of a given firm's unusual purpose. In

example, the Delaware Chancery Court addressed, in part, whether it was acceptable that Craigslist “not be about the business of stockholder wealth maximization.”<sup>270</sup> Craigslist’s charter employed standard any-lawful-purpose language.<sup>271</sup> The court used strong language to hold that two of Craigslist’s original stockholders, Jim and Craig, who held a majority of the firm’s stock and controlled its board, could not eschew shareholder wealth maximization against eBay’s objection after eBay purchased 28.4 percent of the company from the third original shareholder:

The corporate form . . . 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 standards include acting to promote the value of the corporation for the benefit of its stockholders. The “Inc.” after the company name has to mean at least that.<sup>272</sup>

*Unocal*, which the *eBay* court applied, and other decisions by Delaware courts employ nearly as strong language.<sup>273</sup> B Lab today believes that a charter provision adopting a nonstandard purpose would only be enforceable in a jurisdiction governed by a constituency statute.<sup>274</sup>

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any event, corporate law is a state animal, making federal precedent merely persuasive in most cases.

270. *eBay Domestic Holdings, Inc. v. Newmark*, 16 A.3d 1, 34 (Del. Ch. 2010).

271. *Craigslist, Inc.*, Second Amended and Restated Certificate of Incorporation, Jan. 2, 2008; *see infra* text accompanying note 302.

272. *eBay*, 16 A.3d 1 at 34. As this passage suggests, Jim and Craig were involved in the transaction in which eBay acquired its interest. *Id.* at 10. eBay eventually sold its shares back to Craigslist after years of litigation. Leena Rao, *eBay sells a coveted prize back to Craigslist, ending long legal tussle*, *FORTUNE* (June 19, 2015), <http://fortune.com/2015/06/19/eBay-craigslist-stake-buy/>.

273. *Id.* at 31–35; *supra* notes 188–189 and accompanying text; *see supra* Section II.C.

274. *See Corporation Legal Roadmap*, *supra* note 216. B Lab looked into filing charters with nonstandard purposes in California and Delaware in 2010 because those states did not have constituency statutes. *See supra* text accompanying notes 263–268. That experience informs its current view.

Yet most decisional language, although clearly referring to shareholder wealth when viewed in context, leaves room for nonstandard strategic purposes in referring to the “*best interests* of the corporation’s stockholders” and the “*benefit* of its shareholder owners.”<sup>275</sup> And shareholders’ knowing, affirmative, and voluntary waiver of the right to wealth maximization would not subject them to injustice as would a default plenary-board-power rule.<sup>276</sup> The American Law Institute agrees, but acknowledges that little law exists on the enforceability of nonstandard-strategic-purpose charter provisions.<sup>277</sup>

Former Chancellor William B. Chandler III of the Delaware Court of Chancery expressed doubt about changing the fundamental nature of fiduciary duties, charter provisions to the contrary notwithstanding, in a recent lecture.<sup>278</sup> Other commenting jurists have their doubts, but appear cautiously open to the possibility that corporations might validly be chartered to pursue nonstandard ends. Vice Chancellor Laster, while stating that wealth maximization is the “universal . . . standard of [directorial] conduct,” expressed uncertainty about the rule’s mandatory nature: “the principle that corporations must be operated for the benefit of the common stockholders is *likely* itself a default rule that the parties to the corporate contract can modify.”<sup>279</sup> Justice Leo Strine, Jr., appears to view non-shareholder wealth strategic purposes as conceivable, even noble, but unsustainable.<sup>280</sup>

Professor Bainbridge appears to share the jurists’ ambivalence, although he seems to have become more receptive to nonwealth strategic purposes. In 1992, he wrote that “state law arguably does not permit corporate organic documents to redefine the directors’ fiduciary duties” because shareholder wealth maximization was well

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275. See *supra* notes 188–189 and accompanying text (emphasis added).

276. See *supra* text surrounding notes 234–235.

277. 1 AM. LAW INST., 1-2 PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 2.01 reporter’s n.6 [hereinafter ALI REPORT].

278. William B. Chandler III, Presentation at the 8th Annual Berle Symposium: Benefit Corporations and the Firm Commitment Universe (June 28, 2016), <https://law.seattleu.edu/centers-and-institutes/berle-center/symposium/berle-viii>.

279. Laster, *supra* note 168, at 25, 28 n.115 (emphasis added).

280. Leo E. Strine, Jr., *Our Continuing Struggle with the Idea that For-Profit Corporations Seek Profit*, 47 WAKE FOREST L. REV. 135, 149–50 & nn.44–45, 154–55 (2012).

settled.<sup>281</sup> In 2010, referring to ice cream maker Ben & Jerry's social mission, he wrote: "As a contractarian, . . . if Ben & Jerry went public with a [corporate social responsibility] provision in their articles, I'd have no objection."<sup>282</sup> More recently, in discussing *Burwell v. Hobby Lobby*, he referred to shareholder wealth maximization as a mere default rule.<sup>283</sup>

Other academics seem to take for granted the validity of provisions orienting a firm toward non-shareholder wealth ends. Professor Jonathan R. Macey views their enforceability as a consequence of the contractarian aspect of corporations.<sup>284</sup> Professors Easterbrook and Fischel agree, with a more normative undercurrent stressing constituent freedom.<sup>285</sup>

This Article adopts the Macey-Easterbrook-Fischel view as part of its theoretical underpinning. It adds its view of the corporation as a historical bundle of sticks, of which shareholders retain the right to determine corporate ends, and an associational entity through which shareholders pursue their goals. But a charter provision opting out of shareholder value may not meet the demands of public policy given that most shareholders invest for profit in an environment where they have little control and believe that managers have a duty to try to maximize their wealth.<sup>286</sup> Sufficient notice to mid-stream stockholders answers this concern.

## 2. Notice

The success of a corporate-law system accommodating strategic purposes other than shareholder wealth maximization requires

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281. Bainbridge, *supra* note 1, at 985.

282. Stephen M. Bainbridge, *Does eBay spell doom for corporate social responsibility?*, PROFESSORBAINBRIDGE.COM (Dec 6, 2010), <http://www.professorbainbridge.com/professorbainbridgecom/2010/12/does-ebay-spell-doom-for-corporate-social-responsibility.html>.

283. Bainbridge, *supra* note 269.

284. Jonathan R. Macey, *Fiduciary Duties as Residual Claims: Obligations to Nonshareholder Constituencies from a Theory of the Firm Perspective*, 84 CORNELL L. REV. 1266, 1268–69 (1999).

285. See EASTERBROOK & FISCHEL, *supra* note 9, at 36.

286. See *Sterling v. Mayflower Hotel Corp.*, 93 A.2d 107, 117–18 (Del. 1952) (stating that shareholders may alter a common-law rule only if they avoid "a result forbidden by settled rules of public policy").



predictability by and fairness to shareholders.<sup>287</sup> This subsection proposes notice requirements that would alleviate prejudice to shareholders, and then applies it in three case studies.

*a. Form of notice.* In accord with the view of a corporation as a placeholder for stockholder rights, corporate law already allows shareholders to run their firms for any strategic purpose if they are unanimous in their wishes.<sup>288</sup> There is no reason that later-stage, diffusely held firms cannot inherit and be managed to pursue nonstandard ends. Nonstandard purposes should be accepted as legitimate provided that mid-stream shareholders are put on notice via the firm's organic documents, other sources, or both, of the nonstandard terms of the corporate bargains into which they enter.<sup>289</sup>

Given the corporate charter's fundamental role in setting the terms of the corporate contract, inclusion therein of a nonstandard strategic purpose should be a necessary condition of validity.<sup>290</sup> The articles of incorporation would have to clearly distinguish the corporation's strategic and tactical purposes.<sup>291</sup> But a charter provision is likely to put on notice only those with the know-how and resources to obtain corporate charters. Even in the Internet age, obtaining a charter copy from most state chartering agencies can be a complex matter, often involving the payment of nontrivial fees and waiting for

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287. It is worth considering whether nonshareholder constituencies should also be noticed in situations where a corporation's nonstandard strategic purpose is intertwined with its tactical one to the extent that it impacts the firm's income, and by extension its ability to meet other contractual obligations. This potential topic of future work relates to the residual risk-bearing issue mentioned in note 189, *supra*. This Article assumes that nonshareholders are responsible for investigating their counterparties' financial conditions, as in any other contracting situation involving corporations.

288. DEL. CODE ANN. tit. 8, § 350 (2011); 805 Ill. Comp. Stat. §§ 5/7.70–7.71 (West 2015); *see also* eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 34 (Del. Ch. 2010); Clark v. Dodge, 199 N.E. 641, 642 (1936) (holding enforceable a unanimous shareholder agreement restricting the board's managerial authority); ALI REPORT, *supra* note 277, § 2.01 reporter's n.6; Bainbridge, *supra* note 269.

289. This would bind stockholders who dissented from a firm's nonwealth end, eliminating the need for the unanimity otherwise required to pursue a nonwealth purpose. In Craigslist's case, the dissenting shareholder broke unanimity, and won. *See supra* text accompanying notes 270, 288; *infra* note 303 and accompanying text.

290. The charter may also specify a mechanism for shareholders to change their strategic purpose.

291. It might use this Article's nomenclature, referring to the "tactical purpose" and "strategic purpose," or other language indicating the operations in which the corporation may engage and the ends which those operations are intended to promote.

a hard copy of the charter to arrive in the mail.<sup>292</sup> Public corporations must include their charters in their 10-Q and 10-K filings mandated by the Securities Exchange Act of 1934. Although these filings are publicly available, finding them via the Securities and Exchange Commission's EDGAR online database is cumbersome. The filings are more easily searched using third-party databases,<sup>293</sup> but these carry high subscription fees. The difficulty and costs involved in obtaining charters, although not serious impediments for institutional investors,<sup>294</sup> would substantially inhibit notice via charter for the individual holders of roughly half of U.S. equities.<sup>295</sup>

Until, or for a modest period after, it becomes easier for lay investors to obtain corporate charters, additional public dissemination of a firm's nonstandard purpose should be required to deem notice sufficient.<sup>296</sup> Notice may consist of the firm's public behavior, a

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292. For example, the author's research involved obtaining charters from a number of states, including Connecticut, Delaware, Vermont, and Pennsylvania. Obtaining Newman's Own Inc.'s articles of incorporation from Connecticut involved searching for the entity online, sending the state a paper check for \$40, and waiting for the documents to arrive in the mail about 10 days later. Retrieving Craigslist's corporate documents from Delaware required searching for the entity online, paying a \$20 fee by credit card to see more detailed company information and a filing history, going to a different web page and paying another \$36 for the documents, and then waiting for them to arrive in the mail. Getting Ben & Jerry's articles of association from Vermont required searching for the business online, filling out a web form, writing out a paragraph of text describing the requested documents, and waiting for the documents to arrive via e-mail a few days later. Retrieving Conestoga Woods' corporate documents from Pennsylvania involved searching for the entity online, paying a \$15 fee (\$3 each) for the documents, and downloading them immediately.

293. *E.g.*, *Company Filings*, INTELLIGIZE, <http://www.intelligize.com/products/company-filings/> (last visited Sept. 8, 2016).

294. *See* Gordon, *supra* note 259, at 1562–63 (discussing investor attention to charter provisions in a context suggesting that the investors are sophisticated). Institutional investors and others who have easy access to charters may be considered to be on inquiry notice.

295. MATTEO TONELLO & STEPHAN RABIMOV, THE 2010 INSTITUTIONAL INVESTMENT REPORT: TRENDS IN ASSET ALLOCATION AND PORTFOLIO COMPOSITION 22 (2010) (showing that institutions owned 50.6 percent of outstanding U.S. equity in 2009); *see also* ALI REPORT, *supra* note 277, § 2.01 reporter's n.6 (“[T]he mere fact that [a public corporation] has a restriction of this nature in its certificate of incorporation may not be sufficient to make a restriction on the profit motive effective if few shareholders are actually aware of the provision.”).

296. In states like Vermont or Pennsylvania, where shareholders can readily obtain charter copies online at little or no cost, *see supra* note 292, charter notice may be enough now, or in the very near future when knowledge of the existence of general corporations with nonstandard strategic purposes becomes widespread enough to put potential share purchasers on inquiry notice of the need to examine the charters before making equity investments. One might, perhaps, eventually also deem nonchartered public notice sufficient. *See* George A. Mocsary,

conspicuously posted mission statement,<sup>297</sup> private certifications of a firm's nonstandard strategic purpose like those offered by B Lab,<sup>298</sup> or perhaps conspicuous posting of its charter on its website.<sup>299</sup>

*b. Case studies.* It is instructive to apply the suggested notice requirements to a few firms commonly understood to pursue nonstandard strategic purposes, perhaps alongside a wealth-generation end.

(1) *Craigslist*. Craigslist, the famous classified site which gives away most of its advertisements, was founded in 1995 and initially incorporated in California in 1999 as 1010 Cole Street.<sup>300</sup> In 2004 it merged into Craigslist, Inc., a Delaware corporation.<sup>301</sup> Craigslist's initial and two subsequent charters included a generic purpose: "The purpose of the corporation is to engage in any lawful act or activity for which corporations may be organized under the General Corporation Law of Delaware."<sup>302</sup> Under both current law and this Article's proposal, eBay's desire to run the firm for profit destroyed the unanimity required to operate a firm chartered with such a generic purpose for ends other than shareholder wealth maximization.<sup>303</sup> Had

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*Shareholder Wealth Maximization: A Response to Cynthia Williams*, LIBR. L. & LIBERTY (Feb. 20, 2014), <http://www.libertylawsite.org/liberty-forum/shareholder-wealth-maximization-a-response-to-cynthia-williams>.

297. *Cf. About Seventh Generation*, SEVENTH GENERATION, <http://www.seventhgeneration.com/about-seventh-generation> (last visited Sept. 8, 2016).

298. *See supra* text accompanying note 216. Professor J. Haskell Murray discusses benefits and drawbacks of private branding in Murray, *supra* note 185, at 44–46.

299. Some corporations make their charters available online. It is not a ubiquitous practice: of 19 corporations randomly chosen by the author's research assistants (Apple, Ben & Jerrys, Best Buy, BIC, Caterpillar, Clorox, Ford, John Deere, Kroger, Nestle, Nike, McDonald's, Purina, Starbucks, Target, Under Armour, Verizon, Vizio, and Walmart), only nine (Apple, Best Buy, Caterpillar, McDonald's, Nestle, Starbucks, Target, Under Armour, and Verizon) posted their charters.

300. *eBay Domestic Holdings, Inc. v. Newmark*, 16 A.3d 1, 8 (Del. Ch. 2010); CAL. SEC'Y OF STATE, *Business Search*, <http://kepler.sos.ca.gov/> (search for "1010 Cole Street").

301. Certificate of Merger of 1010 Cole Street, Inc., a California Corporation, into Craigslist, Inc., A Delaware Corporation, Oct. 22, 2004.

302. Craigslist, Inc., Certificate of Incorporation, Oct. 13, 2004; Craigslist, Inc., Amended and Restated Certificate of Incorporation, Apr. 25, 2005; Craigslist, Inc., Second Amended and Restated Certificate of Incorporation, Jan. 2, 2008.

303. *See supra* notes 241–245, 261, 269–272, 288 and accompanying text. One might argue that eBay must have known Craigslist's social mission, and should therefore have been held to it. *See also* Johnson & Millon, *supra* note 123, at 12; *supra* note 296. Yet it is equally true, as Chancellor Chandler noted, that Jim and Craig, who were well represented, knew or

Craigslist's charter stated, for example, that "The purpose of the corporation is to provide free online classified advertisements as a service to the public. In doing so, it may engage in any lawful operations, including charging for some classified advertisements," its mission would have been secure.

(2) *Ben & Jerry's*. Ice cream maker Ben & Jerry's was incorporated in 1977 by its two eponymous founders, and began its well-known social mission in earnest in 1982.<sup>304</sup> The company publicly offered stock to Vermont residents in 1984 and went fully public the following year, all while expanding its social mission.<sup>305</sup> As its social works expanded, so did the company's reputation and sales.<sup>306</sup> Its "double bottom line" may have helped it succeed; it may also have contributed to its decline.<sup>307</sup> Takeover offers began in the late 1990s, and in 2000 the company's board accepted Unilever's bid.<sup>308</sup> Reports soon spread that the board sold because it had no choice but to maximize shareholder wealth.<sup>309</sup>

Ben & Jerry's chartered purpose at the time of its sale was:

To engage in the production, manufacture, and distribution, at both wholesale and retail, of ice cream, ice cream novelties, ices, crepes, together with other food and beverages, alcoholic and non alcoholic.

To carry on any other lawful business whatsoever in connection with any of the foregoing or which is calculated directly or indirectly to

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should have known that eBay would seek to have Craigslist run to maximize shareholder wealth and that this would break the unanimity required to do otherwise. *See supra* notes 272, 288 and accompanying text. They nonetheless accepted millions of dollars as part of eBay's acquisition. *eBay*, 16 A.3d at 6, 11.

304. Antony Page & Robert A. Katz, *Freezing Out Ben & Jerry: Corporate Law and the Sale of a Social Enterprise Icon*, 35 VT. L. REV. 211, 216-17 (2010).

305. *Id.* at 218-19.

306. *Id.* at 218-24.

307. *Id.* at 224-25, 226-27 (discussing consumers' views of the company as "a force for good"); Joshua Fershee, *The Wake of the eBay Decision: Is Ben & Jerry's Next?*, BUS. L. PROF BLOG (Dec. 6, 2010), [http://lawprofessors.typepad.com/business\\_law/2010/12/the-wake-of-the-ebay-decision-is-ben-jerrys-next-.html](http://lawprofessors.typepad.com/business_law/2010/12/the-wake-of-the-ebay-decision-is-ben-jerrys-next-.html).

308. Page & Katz, *supra* note 304, at 225-26.

309. *Id.* at 212-13; 228-29.

promote the interests of the Corporation, or to in any way enhance the value of the Corporation.<sup>310</sup>

This statement both affirmed the pursuit of value and contained rather standard purpose language. It thus would not have supported a nonstandard strategic purpose. This is not to say, of course, that the company's board may not easily have gotten away with declining a value-maximizing sale contrary to its fiduciary duties.<sup>311</sup> The point is that the corporation's charter explicitly required wealth maximization.

Interestingly, the charter was amended on August 3, 2000, when Unilever's acquisition was finalized.<sup>312</sup> Although the new charter included a standard purpose,<sup>313</sup> it also adopted a lengthy mission statement:

We have a progressive, nonpartisan social mission that seeks to meet human needs and eliminate injustices in our local, national and international communities by integrating these concerns into our day-to-day business activities. Our focus is on children and families, the environment, and sustainable agriculture on family farms.

- Capitalism and the wealth it produces does not create opportunity for everyone equally. We recognize that the gap between the rich and the poor is wider than at anytime since the 1920s. We strive to create economic opportunities for those who have been denied them and to advance new models of economic justice that are sustainable and replicable.
- By definition, manufacturing creates waste. We strive to minimize our negative impact on the environment.
- The growing of food is overly reliant on the use of toxic chemicals and other methods that are unsustainable. We support sustainable and safe methods of food production that reduce environmental

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310. Ben and Jerry's Homemade, Inc., Articles of Association, Dec. 16, 1977. This purpose did not change through six charter amendments.

311. Page & Katz, *supra* note 304, at 233–42; *see supra* notes 185–186 and accompanying text. The board could easily have pointed to its prosocial activities as having been integral to the company's success, and to assert that, in its judgment, continuing those activities as an independent firm was in the shareholders' best interest.

312. *Our History*, BEN & JERRY'S, <http://www.benjerry.com/about-us#4timeline> (last visited Sept. 8, 2016).

313. Ben & Jerry's Homemade, Inc., Amended and Restated Articles of Incorporation, Aug. 3, 2000 (“The purpose of the Corporation is to engage in any lawful act or activity for which corporations may be organized under the Vermont Business Corporation Act.”).

degradation, maintain the productivity of the land over time, and support the economic viability of family farms and rural communities.

- We seek and support nonviolent ways to achieve peace and justice. We believe government resources are more productively used in meeting human needs than in building and maintaining weapons systems.
- We strive to show a deep respect for human beings inside and outside our company and for the communities in which they live.<sup>314</sup>

On the one hand, a mission statement can be seen as inherently constituting a strategic purpose, coupled with a standard purpose statement best seen as referring only to operations.<sup>315</sup> On the other, the statement refers to integrating this mission into its business operations, suggesting that its mission applies only insofar as it can lead to greater wealth creation (as it has for much of the company's life). Given the public nature of Ben & Jerry's mission, Unilever's commitment to that mission, and the company's having obtained B Lab certification in 2012,<sup>316</sup> it is safe to assume that, should Unilever decide to sell some of its interest in Ben & Jerry's, buyers would have reason to know of the firm's nonstandard purpose.<sup>317</sup>

(3) *Hobby Lobby*. Hobby Lobby started as an arts-and-crafts store that eventually incorporated in 1977.<sup>318</sup> Its certificate of incorporation includes a seventeen-paragraph purpose statement that is essentially an "extensive recital[] of all the conceivable types of business in which the corporation could engage"<sup>319</sup> that also includes language authorizing the pursuit of "any . . . lawful business . . . calculated directly or indirectly to promote the interest of the

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314. *Id.*

315. *See supra* Section II.E.2; note 313.

316. *Ben & Jerry's*, B CORPORATION.NET, <http://www.bcorporation.net/community/ben-and-jerrys> (last visited Sept. 8, 2016).

317. As long as Unilever wholly owns Ben & Jerry's, it can run its subsidiary as it pleases, including enhancing its reputation in pursuit of wealth.

318. *Burwell v. Hobby Lobby Stores, Inc.*, 134 S. Ct. 2751, 2765 (2014); *Hobby Lobby, Inc.*, Certificate of Incorporation, Nov. 28, 1977.

319. *See Welch, supra* note 245, § 102.4; *supra* note 245 and accompanying text.

Corporation or to enhance the value of its property.”<sup>320</sup> The charter does not include reference to the Green family owners’ well-known Christian mission.<sup>321</sup> Despite the absence of a chartered nonstandard purpose, Hobby Lobby has publicized a statement of Christian purpose:

In order to effectively serve our owners, employees, and customers the Board of Directors is committed to:

Honoring the Lord in all we do by operating the company in a manner consistent with Biblical principles.

Offering our customers an exceptional selection and value.

Serving our employees and their families by establishing a work environment and company policies that build character, strengthen individuals, and nurture families.

Providing a return on the owners’ investment, sharing the Lord’s blessings with our employees, and investing in our community.

We believe that it is by God’s grace and provision that Hobby Lobby has endured. He has been faithful in the past, and we trust Him for our future.<sup>322</sup>

Hobby Lobby’s owners have been able to run the corporation in accord with these non-wealth-maximizing principles because they, unanimous in their wishes, executed a shareholder agreement to do so.<sup>323</sup> Were it not for that unanimity and subsequent agreement (which is now binding even if a shareholder changes his or her mind), the

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320. Hobby Lobby, Inc., Certificate, *supra* note 318, at 4.

321. For example, Hobby Lobby stores are closed on Sunday despite a resulting reduction in profits. *Burwell*, 134 S. Ct. at 2766.

322. This purpose was posted on Hobby Lobby’s website from at least October 2, 2009, through April 14, 2015, which covers the period at issue in *Burwell*. *Statement of Purpose*, HOBBY LOBBY, [http://web.archive.org/web/20150501000000\\*/http://hobbylobby.com/our\\_company/purpose.cfm](http://web.archive.org/web/20150501000000*/http://hobbylobby.com/our_company/purpose.cfm) (click on the years and dates within the years in which the site indicates that a snapshot was taken). The current version contains the same text, reordered, and is no longer called a purpose. *Our Story*, HOBBY LOBBY, <http://www.hobbylobby.com/about-us/our-story> (last visited Sept. 8, 2016).

323. *Burwell*, 134 S. Ct. at 2766; *see supra* note 288 and accompanying text.

Greens would not, for at least the medium term,<sup>324</sup> be able to run Hobby Lobby to pursue nonwealth ends in the face of a dissenting stockholder.

### *B. Valid Strategic Purposes*

It remains to determine which strategic purposes the law should recognize. A starting point is any strategic purpose that has potential to create net positive externalities.<sup>325</sup> A starting assumption, in turn, is that any otherwise legal act may constitute a cognizable strategic purpose. But corporations “exist[] by grace of the law that called [them] into being.”<sup>326</sup> Legislatures certainly, and courts via the common law, could limit the strategic (and tactical) purposes for which corporations are formed.

Potential strategic purposes may be grouped into four categories:

- the pursuit of shareholder wealth, via any operations;
- the pursuit of another corporate or outside constituency’s wealth or nonwealth interests, via any operations;
- the pursuit of a public benefit, where the strategic and tactical purposes coincide;
- the pursuit of a nonwealth private benefit for a firm constituency, where the strategic and tactical purposes coincide.

A combination of these is also possible.<sup>327</sup> Each creates first-order private benefits, public benefits, or both; all create significant second-

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324. See *supra* note 296 and accompanying text. Once the structure proposed herein becomes well accepted, a nonchartered purpose declaration may be deemed enough in some circumstances. *Id.*

325. What constitutes a positive externality may be difficult to define. As J. William Callison says, “One man’s global warming is another’s agricultural crop enhancement—who is to say where ‘public benefit’ definitively lies?” Callison, *supra* note 100, at 104. As discussed *supra* Section I.B.2.b, states have many social-benefit-creating reasons for chartering corporations. These benefits are a necessary part of the externality calculus.

326. Peer Zumbansen, *The New Embeddedness of the Corporation: Corporate Social Responsibility in the Knowledge Society*, in *THE EMBEDDED FIRM: CORPORATE GOVERNANCE, LABOR, AND FINANCE CAPITALISM* 119, 140 (Cynthia A. Williams & Peer Zumbansen eds., 2011).

327. For a discussion of the multiple-masters problem potentially created by chartering a firm to pursue multiple strategic purposes, see *infra* Section III.C.1.



order public benefits.<sup>328</sup> They are all, in essence, types of moralities.<sup>329</sup> To limit the exercise of either—pecuniary or otherwise—via the corporate form is effectively to disadvantage it in the marketplaces of commerce and ideas.<sup>330</sup> Given that with proper notice, “the promoters of the firm bear all the agency costs associated with the firm’s governance arrangements,”<sup>331</sup> all should be acceptable corporate ends. This section considers some nuances of each type of strategic purpose.

### *1. Long-term shareholder wealth maximization*

[F]or most of the twentieth century, public companies drove the U.S. economy, producing innovative products for consumers, attractive employment opportunities for workers, tax revenues for governments, and impressive investment returns for shareholders and other investors. Corporations were the beating heart of a thriving economic system that served both shareholders and America.<sup>332</sup>

And it all happened under the centuries-old societal understanding that shareholder wealth maximization was the corporate norm.<sup>333</sup> “That rule has helped produce an economy that is dominated by public corporations, which in turn has produced the highest standard of living of any society in the history of the world.”<sup>334</sup>

But what sort of shareholder wealth maximization? Maximizing *long-term* value, within the bounds of the law is per se proper.<sup>335</sup> Successful long-term planning to improve and develop the firm’s products and services will translate into sustainably increased future cash flows.<sup>336</sup> It is axiomatic that, say, a car company that invests in

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328. Determining what constitutes a benefit may be a difficult task. *See supra* note 325. This Article attempts partly to address this question by distinguishing between first- and second-order benefits. A first-order benefit is connected to a firm’s tactical and strategic purposes, like providing free classified ads. A second-order benefit results collaterally from firm operations, like the generation of tax revenues. *See supra* Section I.B.2.b.

329. Or lack thereof, some might say.

330. By way of example, both churches and abortion clinics incorporate.

331. Gordon, *supra* note 259, at 1556; *see supra* Section III.A.2.

332. STOUT, *supra* note 1, at 10; *accord id.* at 103–04; *supra* Section I.B.2.b.

333. *See supra* text accompanying notes 2–10; Sections II.A.1, II.C; Bainbridge, *SWM Norm*, *supra* note 1, at 1423–24 & nn.2 & 3.

334. Bainbridge, *supra* note 1, at 1446.

335. *See supra* Section II.C.1.

336. No business venture is, of course, ever sure to be successful.

research and development to build ever-better cars will benefit all its constituents in the long term: Customers happier with their cars will buy them in the future and tell their friends to do the same. Robust sales require more production, securing employees' jobs and raises, wealthier suppliers, more secure creditors, and communities with greater employment opportunities and tax bases. The long-run benefit to the shareholder residual claimants is clear: A company with greater and more stable cash flows pays greater and more reliable dividends.<sup>337</sup> In markets functioning somewhat properly, some future cash flow will be capitalized into current share price.<sup>338</sup>

The firm's success results in general good—as President John F. Kennedy famously said, “A rising tide lifts all boats.”<sup>339</sup> Indeed, the stockholder wealth created by public companies—with respect to which the concerns relating to wealth-maximizing behavior are most keen<sup>340</sup>—is being shared by blue- and white-collar employees of nearly every income level. Pension funds have demonstrated their ability and willingness to share in corporate profits and influence firm behavior through their massive stock holdings,<sup>341</sup> and “39% of companies make

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337. Contrary to conventional discourse, shareholder value need not manifest itself in share price. Dividends are a perfectly acceptable way to enhance shareholder wealth, and may reduce the potential for managerial short-termism and other abuse by limiting managers' access to capital. *See supra* note 130; Michael C. Jensen, *Agency Costs of Free Cash Flow, Corporate Finance, and Takeovers*, 76 AM. ECON. REV. 323 (1986).

338. *See supra* notes 113, 201.

339. President Kennedy's entire statement parallels the idea that one firm's success has significant positive externalities: “A rising tide lifts all the boats and as Arkansas becomes more prosperous so does the United States and as this section declines so does the United States. So I regard this as an investment by the people of the United States in the United States.” President John F. Kennedy, Remarks in Heber Springs, Arkansas, at the Dedication of Greers Ferry Dam (Oct. 13, 1963) (transcript available at THE AMERICAN PRESIDENCY PROJECT, <http://www.presidency.ucsb.edu/ws/index.php?pid=9455> (last visited Sept. 8, 2016)); *see also* Sharfman, *supra* note 14, at 393 & n.18. *But see* Bainbridge, *SWM Norm*, *supra* note 1, at 1439 n.57 (noting that where shareholders prefer increased risk, other constituencies may not benefit from shareholder centrality). This is likely priced into contracts with the firm where, for example, employment is typically at will.

340. It is in public corporations that ownership is most separated from control, exacerbating the agency-cost problem. *See supra* Section I.B.1.e.

341. *See, e.g.*, Simon Archer, *Pension Funds as Owners and as Financial Intermediaries: A Review of Recent Canadian Experience*, in THE EMBEDDED FIRM: CORPORATE GOVERNANCE, LABOR, AND FINANCE CAPITALISM, *supra* note 326, at 177, 177–204; Sanford M. Jacoby, *Labor and finance in the United States*, in THE EMBEDDED FIRM: CORPORATE GOVERNANCE, LABOR, AND FINANCE CAPITALISM 277, 304–09; *see also* Sanford M. Jacoby, *Employee Representation and Corporate Governance: A Missing Link*, 3 U. PA. J. LAB. & EMP. L. 449, 452 (2001); Jeffrey

their non-exempt employees eligible to receive some kind of stock option or stock appreciation right.”<sup>342</sup> Further, roughly half of U.S. equities are held by individual investors, and fifty-five percent of people self-report owning stocks individually, via mutual fund, or in a self-directed retirement account.<sup>343</sup> Public companies are, by definition, open for investment by all.<sup>344</sup> The constituencies most often cited as needing protection from the shareholder wealth maximization norm are well positioned to benefit from long-term value creation.

There is no need to “break the power of the shareholder wealth maximization norm.”<sup>345</sup> As Professor Stout says, “To build enduring value, managers must focus on the *long term* as well as tomorrow’s stock quotes, and must sometimes make credible if informal commitments to customers, suppliers, employees, and other stakeholders whose specific investments contribute to the firm’s success.”<sup>346</sup> Of course. *This* is the shareholder wealth maximization that is the law.<sup>347</sup> And because wealth maximization is the most versatile stick in the corporate bundle,<sup>348</sup> others may benefit as well: Cash in hand allows shareholders to donate directly to the causes of their choosing, without self-interested management intermediaries deciding which of *their* favored causes to support.<sup>349</sup>

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H. Birnbaum, *Lobby’s Co-CEO Quit After Probe; Green Issued Loans Without Authorization*, WASH. POST, May 17, 2007, at D1 (reporting that labor is the biggest donor to candidates for federal offices). Labor, indeed, needs wealth maximization to support its defined contribution plans. Martin Gelter, *The Pension System and the Rise of Shareholder Primacy*, 43 SETON HALL L. REV. 909, 911–12 (2013). Pensioner value is a pension fund’s *raison d’être*—its strategic purpose.

342. Corey Rosen, *Equity Compensation: Who Gets What?*, NAT’L CTR. FOR EMP. OWNERSHIP (Apr. 2012), <https://www.nceo.org/articles/equity-compensation-who-gets-what>.

343. Justin McCarthy, *Little Change in Percentage of Americans Who Own Stocks*, GALLUP (Apr. 22, 2015), <http://www.gallup.com/poll/182816/little-change-percentage-americans-invested-market.aspx>.

344. Cf. VERA C. SMITH, *THE RATIONALE OF CENTRAL BANKING AND THE FREE BANKING ALTERNATIVE* 89 (1936) (“[B]efore the advent of the joint stock company [banking] firms had always consisted of a large number of known and wealthy men.”).

345. Murray, *supra* note 185, at 26.

346. STOUT, *supra* note 1, at 110–11 (emphasis added).

347. See *supra* Sections II.B–C; *supra* text accompanying and following note 226; see also *supra* text accompanying notes 37–38, 90.

348. See *supra* note 82 and accompanying text.

349. It is well known that large corporations are more likely to donate to operas and museums than soup kitchens and local schools.

The norm is nevertheless often equated with maximizing short-term stock price.<sup>350</sup> This is understandable in a world (1) dominated by short-term incentive compensation based on share price,<sup>351</sup> (2) empowered managers who are most familiar with the firms under their charge and thus best positioned to extract wealth from them,<sup>352</sup> (3) of whom “80 percent . . . report [that] they would sacrifice future economic value to manage short-term earnings so as to meet investor expectations,”<sup>353</sup> and (4) a business judgment rule that provides managers cover for all but their most obviously self-serving actions.<sup>354</sup> The same holds for politically and legally empowered shareholders willing to use their power, via loyal managers, to their short-term benefit.<sup>355</sup>

Aside from the incentive for fraud, theft, and manipulation that short-termism creates,<sup>356</sup> it can easily skew incentives toward otherwise legitimate-appearing, but value-destroying, activities. It should not be a surprise, for example, that managers compensated on short-term results would prefer putting the firm’s cash into a bank account or far riskier positions if doing so would yield greater short-term returns than research and development, which by its nature is a long-term investment.

Scholarship disagreeing about whether and over which time horizons corporations pursue shareholder wealth abounds.<sup>357</sup> It is

350. *E.g.*, STOUT, *supra* note 1, *passim*; Williams, *supra* note 155.

351. STOUT, *supra* note 1, at 20, 53, 71, 104–06 (discussing also legal provisions, including those in the tax code, that incent short-term compensation packages); Mocsary, *supra* note 113, at 131.

352. Winkler, *supra* note 64, at 911 (noting managers’ “secrecy, skill and evasive . . . methods”); COOK, *supra* note 101, § 643; *see supra* text accompanying and following note 3. These sources show that this problem is not new.

353. Keith L. Johnson & Frank Jan De Graaf, *Modernizing Pension Fund Legal Standards for the Twenty-First Century*, in WILLIAMS & ZUMBANSEN, *supra* note 326, at 459, 464.

354. *See supra* notes 184–186 and accompanying text; *see also supra* Section II.B.

355. *See* STOUT, *supra* note 1, at 52, 112 (discussing proxy-access and other federal regulations making it easier for large shareholders to influence management); Mocsary, *supra* note 113, at 126 (discussing loose distribution rules), 131. Pension funds often fall into this category. *See supra* note 341 and accompanying text.

356. These were perpetrated by Enron management in enormous scale and scope against just about every imaginable internal and external constituency. *See generally*, BETHANY MCLEAN & PETER ELKIND, *THE SMARTEST GUYS IN THE ROOM: THE AMAZING RISE AND SCANDALOUS FALL OF ENRON* (reprint ed. 2013).

357. *Compare, e.g.*, George W. Dent, Jr., *The Essential Unity of Shareholders and the Myth of Investor Short-Termism*, 35 DEL. J. CORP. L. 97 (2010), and Bernard S. Sharfman, *A Theory*

clear, however, that cover for, and incentives to engage in, long-term-value-destroying activities are present.<sup>358</sup> The pursuit of short-run wealth is nevertheless appropriate in the special situations where the long- and short-term are one, like at the *Revlon* moment,<sup>359</sup> or for “companies formed to achieve some specific, short-run objective,”<sup>360</sup> like the development of a leased oil field, where the value of the lease declines markedly over its term.<sup>361</sup> The short-term nature of such corporations’ purpose should be especially well noticed.

Notwithstanding money’s versatility,<sup>362</sup> some shareholders may desire to sacrifice financial returns to achieve other objectives.

## 2. Pursuing nonshareholder constituency interests

A firm might be chartered to pursue the interests of a beneficiary other than its shareholders. The beneficiary may be one with substantial connections with the firm, like the firm’s employees, customers, or community. It may be one not part of the corporate team,<sup>363</sup> like a specified cause or charity.<sup>364</sup>

The benefit may be pecuniary, in which case the firm’s free cash flow not needed to sustain the company in the long term would be paid to the employees as salary, customers as rebates, or its locality or a charity as a donation or a sort-of dividend. It may involve

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*of Shareholder Activism and its Place in Corporate Law*, 82 TENN. L. REV. 791 (2014–2015), with Simon Deakin, *Corporate governance and financial crisis in the long run*, in WILLIAMS & ZUMBANSEN, *supra* note 326, at 15, and Jarrad Harford et al., *Do Long-Term Investors Improve Corporate Decision Making?* (July 2, 2016) (Finance Down Under 2015 and Asian Finance Association 2015 conference paper), <https://ssrn.com/abstract=2505261>.

358. It may be that some measure of managerial short-termism is part of a closer-to-optimal equilibrium than could be realized under a legal rule other than the BJR. *See supra* notes 185–186 and accompanying text.

359. *See supra* text accompanying notes 199–203.

360. Robert N. Anthony, *The Trouble with Profit Maximization*, 38 HARV. BUS. REV. 126, 127 (1960).

361. The lessor would presumably price into the lease the value of this short-term use, and positive law (hopefully) exists to prevent pollution and the like. Oil workers’ pay should likewise price the term of employment.

362. *See supra* note 82 and accompanying and following text.

363. *See supra* text accompanying note 34.

364. More complex analogs that serve these interests exist: corporations can be employee-owned and employees can benefit from profit-sharing arrangements; mutual companies are owned by their customers; municipal corporations engage in profit-making activities; and nonprofits serve many causes. These suggest that true freedom of corporate purpose is feasible.

guaranteeing job security to the extent possible, providing free product to customers, building up a community's infrastructure, or directly serving a charity's beneficiaries.

While the firm is profitable, it makes the specified constituency look more like the corporation's residual claimant while the stockholders join those whose rights—if they retain any—are fixed by contract. The founders presumably formed the corporation from a desire to serve its chartered end, and may retain the rights to vote for directors and to sue them derivatively. They may, however, decide to grant this right to the beneficiary or a third party. When the firm is losing money, however, the stockholders may need to infuse more equity into the firm to keep it going.

### *3. Pursuing a publicly beneficial tactical purpose*

Corporate founders may form a firm strategically purposed to engage in certain tactical purposes<sup>365</sup> that provide first-order benefits to the public. The purpose may be humanitarian, like operating a health-care facility; environmental, like providing free pollution cleanup; religious, providing a place of worship to all comers; or focused on providing a specific service, like giving away classified ads, as does Craigslist,<sup>366</sup> or providing train service, as does Amtrak.

Amtrak, the National Railroad Passenger Corporation, was incorporated by Congress under the District of Columbia Business Corporation Act.<sup>367</sup> It is subject to that Act unless federal law provides otherwise.<sup>368</sup> It was formed—its strategic purpose is—to serve “public convenience and necessity” by providing rail service and meeting other national transportation goals.<sup>369</sup> Although it must “be operated and managed as a for-profit corporation,”<sup>370</sup> it has received perpetual

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365. Some business people may think of this as a “stractical purpose.” See, e.g., Jack S. Duggal, *Next Level Up: Are You a “Stractical” Project Manager?*, PROJECT MGMT. INST. (Dec. 2009), [https://pmi-ctt.org/index.php/resources/newsletter/2007-2009/doc\\_download/15-issue-44-december-2009](https://pmi-ctt.org/index.php/resources/newsletter/2007-2009/doc_download/15-issue-44-december-2009). This Article declines to adopt this amorphous term.

366. See *supra* Section III.A.2.b.i.

367. *Lebron v. Nat'l R.R. Passenger Corp.*, 513 U.S. 374, 385 (1995).

368. Its charter is thus effectively the document filed with the District, as superseded by statute.

369. 49 U.S.C. §§ 24101, 24307 (2012 & Supp. 2015); *Lebron*, 513 U.S. at 383–84.

370. 49 U.S.C. § 24301(a)(2) (2012).

subsidies.<sup>371</sup> The U.S. Supreme Court has held that, despite contrary Congressional intent, Amtrak is not a private corporation because it is government controlled,<sup>372</sup> but there is no reason that private stockholders could not create such an entity.<sup>373</sup>

A continuing entity, whether a general business corporation or nonprofit, needs capital to continue operating. The capital may come from profitable operations, as in Craigslist's case, or from cash infusions by the owners, as in Amtrak's case. Both are acceptable in the case of properly informed private stockholders.<sup>374</sup>

#### *4. Pursuing a privately beneficial tactical purpose*

A final question is whether corporate founders should be allowed to form a corporation to pursue a private benefit where the strategic purpose is to engage in a tactical purpose that provides first-order benefits to stockholders or another constituency. In fact, analogs of this form already exist. Housing cooperatives throughout the U.S. are home to 1.2 million families.<sup>375</sup> The first-order benefits are entirely stockholder-serving: to provide them with a place to live while maximizing their comfort to the extent that the cooperative's finances allow. Other examples include incorporated family farms,<sup>376</sup> and MasterCard, which until 2003 was a nonprofit membership corporation purposed to process its 25,000 member institutions'

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371. Dep't. of Transp. v. Assoc. of Am. R.R.s, 135 S. Ct. 1225, 1232 (2015); *Lebron*, 513 U.S. at 380 n.1, 385. "In its first 43 years of operation, Amtrak has received more than \$41 billion in federal subsidies. In recent years these subsidies have exceeded \$1 billion annually." *Assoc. of Am. R.R.s*, 135 S. Ct. at 1232.

372. *Id.* at 1232–33.

373. Presumably on a smaller scale. *See supra* note 371.

374. The charter may include a provision allowing the board of directors to levy an assessment on shareholders. DEL. CODE ANN. tit. 8, § 102(b)(6) (Supp. 2015). Enforcing an assessment would be prohibitively difficult in the case of a public corporation with diffuse ownership, but possible in theory. A very high stock price, for example, is likely to concentrate ownership in the hands of those who can afford an assessment. *Cf. Berkshire Hathaway Shares Top \$200,000, Buffett Worth Nearly \$66B*, FORBES (Aug. 14, 2014, 1:22 PM), <http://www.forbes.com/sites/steveschaefer/2014/08/14/berkshire-shares-top-200000-buffett-worth-nearly-66b/>.

375. NAT'L CONSUMER COOP. BANK, A CONSUMER'S GUIDE TO BUYING A CO-OP 2 (2007).

376. *See supra* text accompanying notes 48–50. Some, like Ben & Jerry's, consider the support of family farming to be a public service. *See supra* text accompanying note 314.

credit-card transactions.<sup>377</sup> Second-order positive externalities generated by such firms can be substantial and are like those under the shareholder value norm.<sup>378</sup>

### *C. Accountability*

Corporate law is about setting default rules that facilitate efficient transacting and restraining the potential for opportunistic behavior, such as shirking or rent seeking, by the board of directors. General corporations with fully customizable tactical and strategic purposes allow shareholders to create organizational architectures that best balance managerial decision rights, their performance evaluation, and their reward system.<sup>379</sup> Corporate founders possess knowledge of their firms' "particular circumstances of time and place" that makes them the best judges of both how to create monetary or nonmonetary benefits and how to align managerial incentives and protect shareholders.<sup>380</sup>

This section discusses two broad implications of this Article's proposal on organizational architecture. It first discusses how the flexibility to customize corporate purpose alleviates the multiple-masters problem vis-à-vis benefit corporations (b-corps), the most common corporate variant accommodating nonwealth ends, by allowing shareholders to specify a finite set of measurable purposes.<sup>381</sup> It then briefly addresses potential concerns with enforcing fiduciary duties in the context of nonstandard purposes.

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377. EDWARD P. STRINGHAM, ANARCHY AND THE LAW: THE POLITICAL ECONOMY OF CHOICE 304 (2011); Robert E. Litan & Alex J. Pollock, *The Future of Charge Card Networks* 6 (AEI-Brookings Joint Ctr. for Reg. Studies, Working Paper 06-03, 2006).

378. See *supra* Sections I.B.2.b, III.B.1.

379. This Article thus adopts the conceptual framework of University of Rochester Simon Business School professors James A. Brickley, Clifford W. Smith, and Jerrold L. Zimmermen. See JAMES A. BRICKLEY ET AL., *MANAGERIAL ECONOMICS AND ORGANIZATIONAL ARCHITECTURE* viii–ix, 280–450 (3d ed. 2004). Their framework builds on Jensen & Meckling, *supra* note 5, and other work.

380. Todd J. Zywicki & Anthony B. Sanders, *Posner, Hayek and the Economic Analysis of Law*, 93 IOWA L. REV. 559, 561–62, 568 (2008).

381. California's Social Purpose Corporations Act comes closest to the system advocated herein. It allows the formation of "social purpose corporation[s]" that must pursue shareholder profit and either (1) promote one or more public benefit or (2) commit to minimizing its effect on an intra- or extra-firm constituency. CAL. CORP. CODE § 2602(b). The Act does not allow the pursuit of a single purpose.



*1. Off-the-rack alternatives*

The multiple-masters problem is summed up by Professors Easterbrook and Fischel: “[A] manager told to serve two masters (a little for the equity holders, a little for the community) has been freed of both and is answerable to neither. Faced with a demand from either group, the manager can appeal to the interests of the other.”<sup>382</sup> It is said that “[C]orporate decision making is more efficient and effective when management has a single, clearly-defined objective, and shareholder wealth maximization provides not only a workable decision guide but one that, if pursued, increases the total wealth creation of the firm.”<sup>383</sup> Managers, however, are perfectly capable of multitasking.<sup>384</sup> But balancing provides them cover to “serve” the constituency with interests most aligned with their own; managers have shown their willingness to “balance” in this way.<sup>385</sup>

B-corps must serve multiple constituencies. Those formed under the Model Benefit Corporation Act “shall have a purpose of creating general public benefit” and “may [pursue] one or more specific public benefits.”<sup>386</sup> The general public benefit is exceedingly broad, covering “all of the effects of the business on society and the environment,” and is “assessed against a third-party standard.”<sup>387</sup> Pursuing general benefits is mandatory even if the charter specifies a specific public

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382. EASTERBROOK & FISCHEL, *supra* note 9, at 38. Scholarship on the multiple-masters topic is legion. *See, e.g.*, Strine, *supra* note 280, at 150; Mark J. Roe, *The Shareholder Wealth Maximization Norm and Industrial Organization*, 149 U. PA. L. REV. 2063, 2065 (2001); Bainbridge, *SWM Norm*, *supra* note 1 *passim*.

383. John R. Boatright, *What’s Wrong—and What’s Right—with Stakeholder Management*, 22 J. PRIVATE ENTER. 106, 119 (2006) (citation omitted).

384. *See* STOUT, *supra* note 1, at 108.

385. *See, e.g.*, *Revlon v. MacAndrews & Forbes Holdings*, 506 A.2d 173, 184 (Del. 1986) (observing that the “principal benefit” of the Revlon board’s ostensibly serving Revlon’s noteholders “went to the directors”); Bainbridge, *SWM Norm*, *supra* note 1, at 1445–46 (“Many of the same managers who vigorously lobbied state legislators in favor of nonshareholder constituency statutes, were equally vigorous in opposing plant closing laws and other worker protection statutes. Many of the same managers who bewailed the jobs lost after successful corporate takeovers, were silent about the jobs lost because of management defensive tactics. Ironically, much of the anecdotal evidence on the harm to nonshareholders caused by takeovers relates to employees fired after defensive restructurings used by incumbent managers to defeat a hostile bid.”); *supra* notes 351–355 and accompanying text.

386. MODEL BENEFIT CORP. LEGIS. § 201(a)–(b).

387. *Id.* § 102 & cmt.

benefit.<sup>388</sup> Directors are explicitly required to consider the interests of shareholders, employees, suppliers, customers, its and its suppliers' communities, and the local and global environments; they may consider "the interests of *any* other group that they deem appropriate."<sup>389</sup> Delaware allows its b-corps to pursue specifically enumerated public benefits only and makes assessment against a third-party standard optional, but it nonetheless mandates consideration of "the best interests of those materially affected by the corporation's conduct."<sup>390</sup>

If enforcing managerial fidelity under the permissive BJR is difficult, it is impossible when an act otherwise egregious enough to warrant judicial scrutiny can be explained away by pointing to another constituency, especially when managers are required to consider constituencies with interests directly adverse to those of the firm.<sup>391</sup> Such vastly expanded managerial cover may warrant more managerial accountability than demanded by the BJR. Mandating adjudication of the general benefit against a third-party standard may also transfer significant de facto control over corporate affairs from managers to third-parties. It displaces managers' and founders' specific knowledge and "conceptions of the 'good,'" with that of distant strangers.<sup>392</sup> Ironically, the b-corp model may, by upsetting the delicate balance of managerial authority and accountability, undermine both the striking growth that the BJR enables and the corporation's role as a laboratory for socially beneficial endeavors.<sup>393</sup>

The proposal herein would allow founders free reign to set strategic purpose. Their choice would be free of third-party interference and undiluted by a plethora of general public benefits that their firms may be ill equipped to achieve. They could choose ends, including private nonpecuniary benefits, against which firm

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388. *Id.* §§ 201(c), 301 cmt.; *see* Callison, *supra* note 100, at 98.

389. *Id.* § 301(a)(1)–(2) (emphasis added).

390. DEL. CODE ANN. tit. 8, §§ 362(a), 365(a), 366(c)(3) (Supp. 2014, 2015).

391. *See supra* notes 185, 389 and accompanying text; *see also supra* Section II.B.1.

392. Callison, *supra* note 100, at 98–104. The third parties may also be captured by "fourth-party" interests or by a subset of the certified firms.

393. *See supra* text accompanying notes 110, 151–153.

performance is readily measurable while avoiding those that enable cheating.<sup>394</sup>

## 2. *Enforcing shareholder rights*

The chief danger of freedom of corporate purpose is that a shareholder vote in a wealth-maximizing firm will adopt a nonstandard purpose, leaving dissenting shareholders with significantly devalued post-vote shares. In corporations chartered prior to the general acceptance of nonwealth strategic purposes, the acceptance of such purposes should therefore be accompanied by very strong appraisal rights or a near-unanimity requirement—a shareholder vote of at least ninety or ninety-five percent—to adopt nonstandard strategic purposes.<sup>395</sup> A lower threshold, like the two-thirds accompanied by appraisal rights for dissenters required by Delaware to convert a general corporation into a b-corp, should suffice for firms formed after nonstandard purposes become accepted.<sup>396</sup> At that point, founders would be aware of the need to specify a higher threshold in the charter should they desire one. Lower thresholds would enable stockholders with potential non-shareholder

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394. Founders could, of course, purpose a firm with immeasurable ends. They are free to take that risk, and future shareholders are free to buy into it. For more on b-corps' inefficiencies, see Murray, *supra* note 185; Callison, *supra* note 100.

A word on nonprofit corporations is also in order: As for-profit firms currently serve their owners' pecuniary interests, nonprofits serve nonpecuniary ones. Not allowing a customizable middle ground is arbitrarily limiting. At a workshop of this paper, a participant who worked with nongovernmental organizations (NGOs) noted that since 2008 many NGOs have been struggling financially and unable to make up their shortfalls by engaging in profit-making activities. She noted that the availability of the framework proposed herein might have alleviated this problem.

395. Appraisal rights are notoriously inadequate for compensating dissenting shareholders who exercise them in various contexts. *See, e.g.*, *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 466 (1977) (shares appraised at \$150 going concern value in a Delaware short-form merger while the firm's assets were worth \$640 per share).

Delaware initially required 90-percent shareholder approval for a traditional corporation to convert to a benefit corporation, but modified its statute to require only a two-thirds vote, apparently finding that 90-percent was too high when publicly traded Etsy had trouble converting. Haskell Murray, *Amendments to Delaware PBC Law ("The Etsy Amendments")*, BUS L. PROF BLOG (July 3, 2015), [http://lawprofessors.typepad.com/business\\_law/2015/07/amendments-to-delaware-pbc-law-the-etsy-amendments.html](http://lawprofessors.typepad.com/business_law/2015/07/amendments-to-delaware-pbc-law-the-etsy-amendments.html). Delaware's change illustrates the need for a high threshold—the losing one third deserves protection.

396. DEL. CODE ANN. tit. 8, § 363(a) (Supp. 2015).

wealth ends, like pension funds or foundations, too easily to hijack a successful wealth-creating company.

The instant proposal should otherwise have relatively little impact on existing legal rules or their implementation. Ultimate decision-making authority would continue to default to a BJR-protected board.<sup>397</sup> There seems little reason to abandon such a successful governance arrangement, especially considering that firms with nonwealth ends are more likely to be run by their founders or others with a passion for the purpose.

Courts are experienced in applying legal concepts from one area to another. Although it is by design rare for courts to second-guess managers,<sup>398</sup> applying the BJR to ends other than shareholder wealth maximization should be noncontroversial. Asking, for example, whether a merger serves a firm's community rather than its shareholders is well within judges' capabilities. Indeed, they do essentially this when determining whether managers of nonprofits have adhered to their duty of obedience to their organizations' missions.<sup>399</sup> The primary danger is that some difficult-to-quantify nonstandard purposes may obscure managers' self-serving actions. But knowing and willing shareholders should be allowed to risk their capital in this way.<sup>400</sup> Shareholders will, of course, do well to plan ex ante to maximize managerial fidelity, and to retain control of or avoid undertakings where this is overly difficult.

#### CONCLUSION

The general business corporation is a multi-faceted, multi-purpose entity. Its full potential can be realized by freeing it from its one-size-fits-all wealth-maximization application. Long-term shareholder wealth maximization provides a great deal of social benefit; it is the proper default corporate strategic purpose. Nonwealth strategic purposes have similar potential.

Some owners may desire wealth, and purpose their corporations with long-run financial gain. Others may believe that the best path to

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397. *See id.* § 141(a).

398. *See supra* Section II.B.1–2. Professor Haskell Murray terms the application of fiduciary-duty rules to nonstandard purposes the “purpose judgment rule.” Murray, *supra* note 185, at 41–42.

399. NICHOLAS P. CAFARDI & JACLYN F. CHERRY, UNDERSTANDING NONPROFIT AND TAX EXEMPT ORGANIZATIONS § 3.03[C] (2d ed. 2012).

400. *See supra* note 394 and accompanying text; Murray, *supra* note 185, at 41–42.

wealth is indirect, via service to others. Still others may have little interest in making money and seek to enable some other mission with the corporate form. The law should not impose either end upon a stockholder who desires another. Informed shareholders should be allowed to pursue all lawful strategic purposes with their firms.

It remains to be seen how many firms will be chartered with nonstandard ends. The existence of firms like Craigslist, Ben & Jerry's, and Hobby Lobby, where stockholder unanimity enables the pursuit of nonwealth ends, suggests that the number will be nontrivial. Non-wealth-seeking entrepreneurs would no longer have to choose between a general corporation that must pursue wealth and a b-corp with severely diluted managerial accountability. That is a choice between relying on court or board fiat to pursue nonstandard ends, and nothing.

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*Freedom of Corporate Purpose*

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