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SHAREHOLDER WEALTH MAXIMIZATION: A SCHELLING POINT

MARTIN EDWARDS[†]

I. INTRODUCTION

Imagine a reality television game show where two contestants begin the game in two different places in New York City.[1] The object of the game is for the two contestants to find each other, but they do not know anything about each other and they have no way of communicating. If they succeed, both contestants win a prize. If they fail, they get nothing. With no ability to explicitly bargain over the meeting, the parties have to make an educated guess about what the other person is most likely to do. Most people, confronted with this sort of tacit coordination game,[2] will attempt the meeting at a major New York City landmark such as the Empire State Building.[3] Absent any other clues as to the optimal equilibrium meeting point, both parties choose a place that is imaginatively unique and intuitive, expecting that the place will also be unique in the other's imagination.[4] The Empire State Building stands out not because it is a particularly optimal meeting place, but rather because it is iconic, nearly syn-

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[1] *See* THOMAS C. SCHELLING, THE STRATEGY OF CONFLICT 56 (rev. ed. 1980).

[2] *See infra* Section III.A. This coordination game was actually played on television, and all but one pair of teams found one another. *See* AVINASH K. DIXIT & BARRY J. NALEBUFF, THE ART OF STRATEGY: A GAME THEORIST'S GUIDE TO SUCCESS IN BUSINESS AND LIFE 110–11 (2008).

[3] DIXIT & NALEBUFF, *supra* note 2. Many of Schelling's students chose Grand Central Terminal at noon. SCHELLING, *supra* note 1, at 55 n.1. Schelling supposed this was because he was teaching at Yale at the time, and therefore residents of New Haven would think of Grand Central Terminal as the first place they would go if they traveled from New Haven to New York. *See id.*

[4] SCHELLING, *supra* note 1, at 54.

onymous with New York City itself. This is called a "focal point," or "Schelling point," after Professor Thomas Schelling.

There are two important observations that arise from the New York City game: first, that people can coordinate without communication and, second, that value-creating outcomes[5] can be achieved despite multiple equilibria[6] and high transaction costs.[7] As to the former, the fact that many more people than would be expected by chance would likely collect the prize illustrates that coordination without communication is possible.[8]

The latter is more interesting because most real-life coordination occurs with some communication. Thus, logic might suggest that if communication were permitted, the parties would simply bargain to an optimal solution.[9] It could be that one contestant started at Columbia University and the other at Arthur Ashe Stadium, the optimal meeting point was actually equidistant between the two, and the optimal meeting time was around 5:18 a.m., when traffic on the streets was at the lowest.[10] But, even in explicit bargaining contexts, the bargainers still, far more often than logic would dictate, fall back on logically irrelevant but imaginatively simple solutions.[11]

Part of the reason for this is that real-life coordination, perhaps unlike the New York game, involves some degree of embed-

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[5] "Value-creating" is the term used here because, importantly, focal points do not always lead to optimal outcomes. Law-and-economics, like economics, has long concerned itself with finding the optimal. Some definitions are formal statements of economic efficiency (e.g., Pareto efficient, Kaldor-Hicks efficient), while others are intuitive (e.g., appropriate level of corporate manager attention to voluntary efforts at protecting the environment). Similarly, some argue that optimality is derived from measures of utility or wealth, or that free exchange defines and begets utility and wealth. *See, e.g.*, FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 6–7 (1996).

[6] In the New York game, *any* meeting place could be a "winning" equilibrium.

[7] *See* N. Gregory Mankiw, *New Keynesian Economics*, *in* THE CONCISE ENCYCLOPEDIA OF ECONOMICS 379, 381 (David R. Henderson ed., 2008). Here, transaction costs are the cost of negotiating a meeting place if communication were available. *See* Robert Cooter, *The Cost of Coase*, 11 J. LEGAL STUD. 1, 20–21, 23 (1982).

[8] *E.g.*, SCHELLING, *supra* note 1, at 114 (describing the situation where two spouses lose track of each other in a store and must coordinate to find each other and go home).

[9] *See, e.g.*, *id.* at 50.

[10] *See* Ben Wellington, *Quantifying the Best and Worst Times of Day To Hit the Road in NYC*, I QUANT NY (Aug. 5, 2014, 12:34 AM), https://iquantny.tumblr.com/post/93845043909/quantifying-the-best-and-worst-times-of-day-to-hit [https://perma.cc/6Q5D-AN4K] (finding that the lowest-traffic time of day in New York City is 5:18 a.m., which is when taxis were able to maintain the highest average speed).

[11] SCHELLING, *supra* note 1, at 67.

ded conflict.[12] Both sides want to get the best deal possible for themselves which, while the transaction as a whole will make both sides better off if a deal is reached, does not mean there is not a conflict over who gets the greater share of the surplus created by the transaction. That conflict, in turn, makes the commitments proposed in the explicit bargain less than credible, as they might be made out of strategic motive to capture more of the surplus rather than one of facilitating the exchange. In a sense, this diminishment in credibility devolves the explicit bargaining back into tacit bargaining, because communication that lacks credibility is likely to lead to the same place as not communicating at all: settling for a Schelling point or not making a deal.[13]

The other reason is that discovering and implementing these optimizations is costly. Once the bargain reaches the stage where continuing to optimize gets too costly—either strategically or otherwise—the parties can, and often do, choose the logically irrelevant and perhaps suboptimal, yet contextually intuitive, solution to break the strategic deadlock or forgo the additional costs.[14]

Finally, a word on what makes a point contextually intuitive. One way is physical or geographic uniqueness—the Empire State Building is very tall and associated in the popular mind with New York City. Another way is that once bargainers agree on a Schelling point as the way to conclude their bargain, they will return to it in future bargains—again, to avoid costs.[15]

These, then, are the primary features of Schelling points: they permit coordination in high-transaction-cost, multiple-equilibrium environments because they are contextually intuitive. They are value-creating, though not always optimal—that is, another equilibrium might be more optimal by a given measure, but the one that is contextually intuitive makes coordination easier and more likely. They may be contextually intuitive due to some characteristic—for example, the Empire State Building's association with New York City—or due to having been productively used to coordinate people in prior dealings, or, often, both.[16]

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[12] *See generally* Robert B. Ahdieh, *The Strategy of Boilerplate*, 104 MICH. L. REV. 1033 (2006). Of course, one party could always push the other to come to her location or a location more convenient for her.

[13] *See* SCHELLING, *supra* note 1, at 67; *see also* David Friedman, *A Positive Account of Property Rights*, 11 SOC. PHIL. & POL'Y 1, 13 (1994).

[14] *See* SCHELLING, *supra* note 1, at 67.

[15] Friedman, *supra* note 13.

[16] *See infra* Sections IV.B.1–2.

A Schelling point is an intuitive, if imperfect, place for bargainers to conclude a bargain where a suboptimal bargain is superior to no bargain at all.

Shareholder wealth maximization is the norm within corporate law and governance holding that directors' and officers' roles are, fundamentally, to maximize the long-term value of the corporation, and thus the value of its shares of stock.[17] The debate over whether it is or should be the norm or the law for corporations is usually contested on different theories of economic or social value, and, of course, legal precedent.[18] The extant law-and-economics theories of corporate law view shareholder wealth maximization as an efficient term in a hypothetical bargain between corporate managers and directors on one side and shareholders on the other side.[19] The argument goes that it has, by reason of this efficiency, emerged as the law.[20] Competing theories rest on a rejection of this "contractarian" theory of the firm due to empirical results that run counter to the theory, persistent counterfactuals that undermine the norm's existence, and scant hard precedent for the norm.[21] At times in the wide-ranging academic and public debate, commentators have called for dividing managerial focus among wealth maximization and other matters such as worker wealth, environmental sustainability, and other nonfinancial social concerns.[22]

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[17] STEPHEN M. BAINBRIDGE, CORPORATE LAW 245 (3d ed. 2015); PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 2.01 (AM. L. INST. 2008). *But see* Eric Franklin Amarante, *What We Talk About When We Talk About Shareholder Wealth Maximization*, 19 TRANSACTIONS 455, 459–62 (2017) (illustrating the complexity buried just within the words "shareholder," "wealth," and "maximization"). One of the myriad debates that involves shareholder wealth maximization is about what it actually means. *See id.* at 459.

[18] Lynn A. Stout*, Bad and Not-So-Bad Arguments for Shareholder Primacy*, 75 S. CAL. L. REV. 1189, 1192, 1199–1202 (2002).

[19] Jonathan R. Macey, *A Close Read of an Excellent Commentary on* Dodge v. Ford, 3 VA. L. & BUS. REV. 177, 185 (2008).

[20] EASTERBROOK & FISCHEL, *supra* note 5, at 120–21.

[21] *See* Stephen M. Bainbridge, *In Defense of the Shareholder Wealth Maximization Norm: A Reply to Professor Green*, 50 WASH. & LEE L. REV. 1423, 1428 (1993). *See infra* Section II.A; Stout, *supra* note 18, at 1192–93, 1208 (stating that ownership and residual claimant theories are "empirically incorrect" and "false"); Ann M. Lipton, *What We Talk About When We Talk About Shareholder Primacy*, 69 CASE W. RSRV. L. REV. 863, 868–69 (2019) (proposing the different hypothetical desires of shareholders that may be in conflict with increasing the value of the residual claim).

[22] Ronald M. Green, *Shareholders as Stakeholders: Changing Metaphors of Corporate Governance*, 50 WASH. & LEE L. REV. 1409, 1411 (1993).

This Article, purposely, does not stake a position on whether shareholder wealth maximization is socially optimal, or whether expanding corporate governance to include greater focus on other matters would be better. Instead, it reflects on the role the norm plays in coordinating people and money. It strives to illustrate that shareholder wealth maximization "works" because it is a contextually intuitive way to coordinate within the high-cost, multiple-equilibrium bargaining environment associated with large public corporations.

Capital is necessary to run a corporation and generally, corporations cannot obtain enough capital from debt-financing sources. For that reason, they must sell stock or equity. That arrangement, like all the other contracts that make up the corporation, must consist of some kind of bargain. This Article proposes that selling stock or equity is an arrangement of the kind Professor Schelling describes—a coordination game with embedded conflict.[23] Given the practical impediments to actual bargaining, the value of coordinating investment and resolving of conflicts between the shareholders and the managers and directors by settling on shareholder wealth maximization is reflected in the fact that this bargain is so often struck. One way to describe this process is as Professor Schelling did—that there was something contextually intuitive about the idea of maximizing shareholder wealth.

Everyone who might want to invest in any corporation or run one understands, in general, what it means for a corporation to orient itself toward maximizing shareholder wealth.[24] The key observation is that the shareholders recognize, generally, that managers and directors are going to be trying to maximize wealth. This recognition is independent of any individual shareholder's actual desires or purposes, regardless of whether those desires or purposes are advanced or frustrated by the norm—that is, even if shareholders wanted managers and directors to do something else, they generally know that managers and directors

[23] *See also* Manuel A. Utset, *Towards a Bargaining Theory of the Firm*, 80 CORNELL L. REV. 540, 582 (1995) (describing the bargaining between individual shareholders and the managers as a tacit bargain of the kind Schelling analyzed).

[24] This is not to say that every person's actual decisions in any given transaction or case will be in alignment. It just means that the concept of focusing on maximizing corporate wealth is relatively simple. *Cf.* Lipton, *supra* note 21, at 891–92.

will be trying to maximize wealth.[25] This sheds some light on why it might have emerged as the norm for animating director and officer conduct in the beginning, why it has been enshrined in the law in Delaware and elsewhere, and why it continues as a norm today. In sum, I hope this Article answers the question: Why is shareholder wealth maximization so persistent, even granting its inefficiencies, shortcomings, and even granting its occasional failure to result in anyone's wealth being maximized? The posited answer is that shareholder wealth maximization's contextual intuitiveness has resulted in its becoming a load-bearing part of corporate governance. It is persistent for its usefulness, if not always preferred for its optimality. In the hypothetical bargain between the managers and directors on one side, and the shareholders on the other, shareholder wealth maximization represents a value-creating, if not always optimal, equilibrium.

It is important to add that the public is taking a more keen interest in the role of corporations in society.[26] Many view shareholder wealth maximization as socially harmful, or, at minimum, a powerful impediment to social progress or change.[27] While describing shareholder wealth maximization as a Schelling point is not the sort of idea that would necessarily respond to calls for reform premised upon the need for social change, understanding its persistence should be a part of the debates to come. There is no doubt that the economics, social value, and legal doctrine will be up for debate over the next few years, but the debate will be incomplete without a full account of the norm's coordinating function. This Article, hopefully, contributes part of such an account.

This Article proceeds in five parts. Following this Introduction, Part II provides a brief overview of the extant theories of the firm, the way these theories interact with existing doctrines,

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[25] *Cf.* SCHELLING, *supra* note 1, at 58–59 (discussing how one person would "grimly acknowledge" that he or she must go to the other if the only location that both recognize is where the other person is located); Lipton, *supra* note 21, at 867.

[26] David Gelles & David Yaffe-Bellany, *Shareholder Value Is No Longer Everything, Top C.E.O.s Say*, N.Y. TIMES (Aug. 19, 2019), https://www.nytimes.com/2019/08/19/business/business-roundtable-ceos-corporations.html [https://perma.cc/3SDT-JJKU].

[27] *See generally* Addisu Lashitew, *Building a Stakeholder Economy*, BROOKINGS (Oct. 28, 2020) https://www.brookings.edu/blog/future-development/2020/10/28/building-a-stakeholder-economy/ [https://perma.cc/PG75-FAC7].

and the most competitive alternative models. It then situates shareholder wealth maximization within that constellation of theories. Part III describes the provenance of Schelling points, how they arise from the existence of multiple equilibria and transaction costs, and how their coordinating power arises from their objectivity and intuitiveness. Part IV explains how the simple, intuitive idea of shareholder wealth maximization fits the definition of a Schelling point. It presents the core argument of this Article: that shareholder wealth maximization serves as a load-bearing coordinating function due to its contextual-intuitiveness that exists alongside, and perhaps even independent of, its current justifications. That is, shareholder wealth maximization being a Schelling point that solves the costly bargaining problem in corporate law explains its persistence, if not its superiority. Part V is a brief conclusion.

II. THE THEORY AND DOCTRINE OF SHAREHOLDER WEALTH MAXIMIZATION

Shareholder wealth maximization has a complex doctrinal and theoretical history. Debates about it have been going on for quite some time.[28] As a descriptive matter, there are debates over whether the norm truly exists at all and whether it is a binding legal principle or not. One Delaware judge has answered this question with the claim that the norm is so doctrinally sound as to be very nearly beyond reasonable questioning,[29] and a recent Delaware case reached the same conclusion.[30] Normatively, the primary justifications for shareholder wealth maximization are that it is economically efficient[31] and socially useful,[32]

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[28] *See infra* Section II.A; *see also* George A. Mocsary, *Freedom of Corporate Purpose*, 2016 BYU L. REV. 1319, 1320 ("Every few decades, there erupt political and academic debates over the proper nature and purpose of the corporation.").

[29] *See* Leo E. Strine, Jr., *The Dangers of Denial: The Need for a Clear-Eyed Understanding of the Power and Accountability Structure Established by the Delaware General Corporation Law*, 50 WAKE FOREST L. REV. 761, 768 (2015) [hereinafter *Dangers of Denial*]. Nonetheless, Judge Strine has recently distributed a new paper arguing for formally changing much of this quite substantially. *See* Leo E. Strine, Jr., *Toward Fair and Sustainable Capitalism: A Comprehensive Proposal To Help American Workers, Restore Fair Gainsharing Between Employees and Shareholders, and Increase American Competitiveness by Reorienting Our Corporate Governance System Toward Sustainable Long-Term Growth and Encouraging Investments in America's Future* 4 (U. Pa., Inst. for L. & Econ. Rsch., Paper No. 19-39, 2019).

[30] eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 34–35 (Del. Ch. 2010).

[31] "Economically efficient," for the moment, refers collectively to traditional principles of welfare economics, along with the contributions of transaction costs

and that it is generally equitable to shareholders and other parties to the corporate contract.[33] Similar justifications include the cost-saving value of off-the-rack corporate default rules, which are premised upon the proposition that such rules should reflect what a majority of hypothetical bargainers would choose in a costless environment.[34] The private ordering or bargaining that results as individuals contract around these defaults—or do not—reveals the most economically efficient terms.[35] The prevailing view of corporate law is "contractarian"; corporate law and governance consists of a nexus of interlocking contracts between various corporate constituents, not all of which are formally or extensively bargained.[36] In particular, the contract with the shareholders of a large, public corporation is typically not bargained at all.[37]

Nonetheless, there is intense debate over whether shareholder wealth maximization is—descriptively—the law in Delaware,[38] and—normatively—whether it is actually economically superior, socially useful, or equitable to animate directors' and

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economics and the new institutional economics. *See* William W. Bratton & Michael L. Wachter, *Shareholders and Social Welfare*, 36 SEATTLE U. L. REV. 489, 499 (2013); *see also* Oliver Williamson, *Corporate Governance*, 93 YALE L.J. 1197, 1210 (1984) (drawing upon transaction costs economics to develop a framework for "contractual governance" between directors and shareholders).

[32] Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. L. REV. 547, 549 (2003).

[33] At least one commentator has suggested that fairness follows from the overall economic efficiency gains of shareholder wealth maximization. *See* Mark J. Roe, *The Shareholder Wealth Maximization Norm and Industrial Organization*, 149 U. PA. L. REV. 2063, 2065 (2001); Macey, *supra* note 19, at 185 (linking shareholder wealth maximization to the contractarian theory of the firm—that is, that the contract between the managers and directors on one side, and shareholders on the other, includes a term obligating the former to increase the value of the residual claim, since that is the only thing that the shareholders bargain for).

[34] *See* Bainbridge, *supra* note 21, at 1430–31 (defending, simultaneously, the shareholder wealth maximization norm and limited liability as transaction-costs-reducing default rules within the corporate form); *see also* EASTERBROOK & FISCHEL, *supra* note 5, at 15. To some extent, this Article's contribution hopefully will be to show that Schelling points represent the mechanics or plumbing of individuals working around the transaction costs they find in markets.

[35] See EASTERBROOK & FISCHEL, *supra* note 5, at 34–35.

[36] Bainbridge, *supra* note 21, at 1427.

[37] Green, *supra* note 22, at 1413–14; *see also* Utset, *supra* note 23.

[38] *See, e.g.*, Stout, *supra* note 18, at 1189–90; Bainbridge, *supra* note 21, at 1423–25 ("Delaware's courts and legislature . . . are still our premier corporate lawmakers.").

officers' duties with such a legal rule.[39] Descriptive arguments against shareholder wealth maximization include the dearth of clear doctrinal history supporting it, the lack of clarity in Delaware cases about the specificity of its requirements, and the rarity of its direct enforcement due to judicial deference to the authority of directors and officers.[40] Normative arguments include charges that the norm does not necessarily or actually result in economic efficiency,[41] that shareholders' hypothetical and real private views of their own wealth and welfare are often rejected,[42] and that maximizing shareholder wealth actually means imposing costs on other corporate constituents or on society that are not worth the economic gains.[43] Similarly, some commentators propose that shareholder wealth maximization-driven corporate governance should be reformed or reinterpreted such that it takes greater account of workers, environmental sustainability, and other non-financial social matters. Scholars have at times theorized this as a "multifiduciary stakeholderist" model, while popular commentary has described related reforms as "corporate social responsibility" ("CSR") or "environmental and social governance" ("ESG").[44] Collateral debates about the divi-

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[39] *See* Lynn A. Stout, *Why We Should Stop Teaching* Dodge v. Ford, 3 VA. L. & BUS. REV. 163, 165 (2008); Green, *supra* note 22, at 1410–11; Mocsary, *supra* note 28, at 1321.

[40] *See* Mocsary, *supra* note 28, at 1354; *see also* Bernard S. Sharfman, *Shareholder Wealth Maximization and Its Implementation Under Corporate Law*, 66 FLA. L. REV. 389, 407 (2014).

[41] *See, e.g.*, Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 280–81, 291–92 (1999) (arguing that the economic benefits of the corporate form flow from the conscious allocation of inputs and outputs by an independent hierarch—the board—rather than the board's focus on maximizing the wealth of one class of corporate contributors—the shareholders).

[42] *See* Daniel J.H. Greenwood, *Fictional Shareholders: For Whom Are Corporate Managers Trustees, Revisited*, 69 S. CAL. L. REV. 1021, 1025 (1996) (arguing that corporate law treats shareholders as a legal fiction rather than drawing upon the actual desires of human shareholders); *see also* Lipton, *supra* note 21, at 865–66 (elucidating the shifting sands in corporate law from the assumed desires of dispersed, uncommunicative shareholders to the actual preferences of institutional investors and others with expressed preferences). This is thought to undermine the case for private ordering. *Id.* at 882–83.

[43] *See* Caleb N. Griffin, *The Hidden Cost of M&A*, 2018 COLUM. BUS. L. REV. 70, 110 (without expressly arguing against shareholder wealth maximization, illustrating the extent to which it could produce social harms previously underappreciated in traditional law-and-economics scholarship).

[44] *See generally* James Mackintosh, *A User's Guide to the ESG Confusion*, WALL ST. J. (Nov. 12, 2019, 8:00 AM), https://www.wsj.com/articles/a-users-guide-to-the-esg-confusion-11573563604 [https://perma.cc/9Q8S-QTVE].

sion of authority between management and shareholders,[45] policing conflicts of interest,[46] the question of whether wealth is to be maximized in the short- or long-term,[47] and, as always, whether the decision maker should be the state or the private parties themselves[48] also interact with discussion of shareholder wealth maximization.

Purposely, this Article does not claim to move the ball one way or another on these debates. Certainly, the contractarian case for shareholder wealth maximization is formidable. Skeptics, though, have made persuasive arguments and presented thoughtful alternative models. CSR/ESG reformers and the theorists who came before them also bring significant ideas to the table—ideas that corporate managers themselves are now arguably taking seriously.[49] Instead, this Article hopes to further the understanding of the function and operation of the shareholder wealth maximization norm by describing it as a Schelling point.

This Section combines the component parts of any discussion of corporate law and governance: the theory of the firm as developed through economics and finance, the models developed in the legal scholarship, the scholarship on the shareholder wealth maximization norm itself, and the relevant doctrine.

A. *Economic Theories and Legal-Economic Models of the Corporation*

The modern theory of corporate law and governance is a heavily economic one—in many ways the economics have overshadowed the doctrine, even as Delaware and other states have tended toward guiding the doctrine toward the economics. At the outset, it is important to note that shareholder wealth maximization largely operates in the background of much of the economic

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[45] *See* Lucian Ayre Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 836 (2005).

[46] ADOLF A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 277–78 (1931); *see also* Bebchuk, *supra* note 45.

[47] Leo E. Strine, Jr., *Who Bleeds When the Wolves Bite?: A Flesh-and-Blood Perspective on Hedge Fund Activism and Our Strange Corporate Governance System*, 126 YALE L.J. 1870, 1884 (2017).

[48] Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 VAND. L. REV. 83, 84–85 (2004).

[49] *See, e.g.*, *Statement on the Purpose of a Corporation*, BUS. ROUNDTABLE (Aug. 19, 2019), https://system.businessroundtable.org/app/uploads/sites/5/2021/02/BRT-Statement-on-the-Purpose-of-a-Corporation-Feburary-2021-compressed.pdf [https://perma.cc/H73W-VQGJ].

theory.[50] This is in part because, as this Article has called it, shareholder wealth maximization might better be thought of as a norm[51] than a binding—or default[52]—legal principle.[53] It is, in fact, one of the many grounds on which the varying debates on shareholder wealth maximization take place.[54] This Part makes an effort to corral all of these competing ideas, by providing a background in the current state of shareholder wealth maximization, the norm and the law, through a brief overview of the economic theories and legal doctrine associated with it.

Today's corporate law and economics begins with Professor Ronald Coase's *The Nature of the Firm*, in which he argued that transaction costs—described in that article as the costs actors must incur to use the price mechanism—cause individuals to gather into firms to carry out economic activity.[55] Perhaps implicit in Professor Coase's work was that this was done according to contract-like agreement.[56] Professor Coase observed that the economics of the time seemed to take as a given that either a firm or an individual could be "the" economic actor for the purpose of analyzing supply, demand, price, equilibrium, and allocation of resources questions.[57] Professor Coase wondered why individual economic actors would choose to act collectively as a firm under the command and control of a boss or entrepreneur.[58] Indeed, command-and-control was supposed to be the model competing with the market, where economic actors were thought to constantly be responding to prices transmitted through these market processes.[59] But Professor Coase observed individ-

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[50] *See generally* Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 306 (1976) (noting that corporate managers don't always "literally" maximize wealth).

[51] Joan MacLeod Heminway, *Shareholder Wealth Maximization as a Function of Statutes, Decisional Law, and Organic Documents*, 74 WASH. & LEE L. REV. 939, 939 & n.1 (2017) (citing JONATHAN R. MACEY, CORPORATE GOVERNANCE: PROMISES KEPT, PROMISES BROKEN 32–33 (2008)).

[52] Mocsary, *supra* note 28, at 1342–43.

[53] The doctrine is discussed more thoroughly in Section III.D, *infra*.

[54] *See* Mocsary, *supra* note 28, at 1342.

[55] R. H. Coase, *The Nature of the Firm*, 4 ECONOMICA 386, 390–92 (1937).

[56] *See* Armen A. Alchian & Harold Demsetz, *Production, Information Costs, and Economic Organization*, 62 AM. ECON. REV. 777, 783–84 (1972).

[57] Coase, *supra* note 55, at 387. Then and now, the study of economics is about the allocation of resources. N. GREGORY MANKIW, PRINCIPLES OF ECONOMICS 2 (9th ed. 2021).

[58] Coase, *supra* note 55 at 388.

[59] *Id.* at 390.

ual people inside firms responding to commands through a hierarchy, where the person at the top was the one who responded to the prices.[60]

Professor Coase concluded that no economic actor can participate directly in the market process of responding to prices without expending some sort of cost.[61] If that cost became too great, then the economic actor could not avail herself of the economic benefits of an exchange at the market price. Thus, firms formed and entrepreneurs, on firms' behalf, acted upon the prices developed in the market process. Since Professor Coase proposed his theory of the firm, scholars have been working to develop a model of how law and economics work together to manage the transaction costs Professor Coase first observed.

Following Professor Coase, Professors Armen Alchian and Harold Demsetz published their seminal work, "Production, Information Costs, and Economic Organization."[62] They described the firm as a "contractual structure" that developed to "enhanc[e] efficient organization of team production."[63] Professors Alchian and Demsetz provided one of the first formidable efforts at answering the questions Professor Coase's observations first raised, as well as presenting their own set of questions.[64] Their exploration of the firm defined it as a set of contracts where a central agent serves as the common counterparty in contracts with all the inputs of production. While Professor Coase focused on the *costs* associated with individuals using the market, Professors Alchian and Demsetz expanded the analysis to include the increased productivity created through "team production."[65] They also developed a framework for analyzing the extent to which firms must expend costs on monitoring employees and trying to prevent them from shirking, a natural problem in any team productive activity. Their quibble with Professor Coase, if they had one, was Professor Coase's framing of the firm as somehow an "authoritarian" process instead of a "contractual" one.[66] For the purposes of this Article's claims, the most important concept was the connection between what

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[60] *Id.* at 390–91.
[61] *Id.* at 392.
[62] *See generally* Alchian & Demsetz, *supra* note 56.
[63] *Id.* at 794.
[64] *Id.* at 783–84.
[65] *Id.* at 779–81.
[66] *Id.* at 783.

Professor Alchian and Demsetz called the "central agent" and the "residual claim"[67]—that is, that the party holding the residual claim would be best incentivized to monitor the other inputs because that party is best incentivized to get the most surplus out of the team productive activity.[68]

Professors Michael Jensen and William Meckling, along with Professor Eugene Fama, continued crafting the theory, illustrating that the voluntary but authoritative system wherein managers and directors exercised wide discretion was the most efficient way to organize collective economic activity.[69] Professors Jensen and Meckling's most important proposition was that the corporation was a "nexus" of contracts between the various factors of production.[70] This suggests the shareholder wealth maximization norm is a term of the implicit contract between the managers, directors, and shareholders.[71] That is, corporate shareholders are trading investment capital to the firm in exchange for a slice of the residual claim, and, therefore, they should reasonably expect the managers and directors to maximize the value of the residual claim. Professors Fama and Jensen's later work developed an explanation for why splitting the residual claim and assigning its monitoring function to the board of directors was a workable solution to the agency costs Professors Alchian, Demsetz, Jensen,

[67] The "residual claim" refers to the person who gets the surplus after all other inputs have been paid. As Professors Alchian and Demsetz described the capitalist firm, the shareholders would be the residual claimants, as they stood to benefit the most from income produced over and above what all other parts of the team are paid.

[68] One question Professors Alchian and Demsetz puzzled over, but did not quite answer, is how the splitting of the residual claim from the central monitoring agent and distributing it among a lot of shareholders in a corporation would serve to discipline the monitor for shirking his or her responsibility to discipline the other inputs. When the central agent *is* the residual claimant, incentives are, of course, aligned, and the right to the value of the residual claim disciplines the central monitoring agent. Professors Alchian and Demsetz observed that the shareholders would certainly not take any authority with their piece of the residual claim, and instead suggested that stockholders are basically just more optimistic bondholders. In the end, the connection between the open-ended residual claim and the central monitor suggests that the central monitor's expected role is to increase the value of the residual claim. Professors Alchian and Demsetz credit Professor Henry Manne with the proposition that no shareholder would *expect* any sort of control. *See also infra*, Section II.A (discussing Manne); Williamson, *supra* note 31, at 1224–29.

[69] Jensen & Meckling, *supra* note 50, at 310. Professors Jensen and Meckling's robust new economic explanation of the boundaries of the firm undermined the prior legal scholarship of Professors Berle and Means, who had argued that agency costs were and would continue to wipe out any gains from incorporation. *See* Bratton & Wachter, *supra* note 31, at 494–97.

[70] Jensen & Meckling, *supra* note 50, at 310.

[71] *Id.* at 311 & n.13; *see also* Alchian & Demsetz, *supra* note 56, at 777, 794.

and Meckling had all been considering.[72] In other words, while the shareholders would have the best incentives to monitor all the inputs, they will not because their individual share of the residual claim is so small and their relationship to the corporation itself is so attenuated. So the corporation places that monitoring authority in the hands of the board of directors.

Professors Jensen and Meckling's work connected to Professor Coase's, as it appeared to identify the boundary of the firm and the market by framing it in terms of the "agency costs"[73] associated with the "nexus of contracts" underlying the legal fiction of the corporation.[74] In the end, similar to Professors Alchian and Demsetz, Professors Jensen and Meckling concluded that the nexus of contracts associated with the firm was the way that "conflicting objectives of individuals . . . are brought into equilibrium within a framework of contractual relations."[75] The engine of the analysis was a reframing of agency costs: rather than follow, for example, Professors Adolph Berle and Gardiner Means's assumption that the positive quantity of agency costs ensured inefficiency, Professors Jensen and Meckling concluded that if the value of the production exceeded all relevant costs—including agency costs—then joint production through firms was still wealth-enhancing.[76] Finally, Professor Oliver Williamson also contributed a key observation to the research on corporate governance. He explained why the residual claimants should be the principal and the managers and directors the agent—that is, because other creditors all could negotiate the terms of their arrangements, while the widely dispersed shareholders, who have little interest or ability to actually manage the corporation, cannot or simply do not negotiate the terms of their participation in the firm.[77]

Professor Henry Manne contributed a well-developed legal model of the large, public corporation that presaged much of the economics and finance literature discussed above. In "Our Two

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[72] Eugene F. Fama & Michael C. Jensen, *Separation of Ownership and Control*, 26 J.L. & ECON. 301, 308–09 (1983).

[73] Jensen & Meckling, *supra* note 50, at 310.

[74] Fama & Jensen, *supra* note 72, at 302.

[75] Jensen & Meckling, *supra* note 50, at 311.

[76] *Id.* at 328 (citing Professor Demsetz's "Nirvana" fallacy to reject claims that high agency costs would wash increased productivity from equilibrium organization of inputs).

[77] Williamson, *supra* note 31, at 1228.

Corporation Systems: Law and Economics"[78] and "Mergers and the Market for Corporate Control,"[79] Professor Manne argued, in part, that shareholders in large public corporations with freely tradeable shares were simply suppliers of investment capital. The management and control of the corporation were not the shareholders' concern; they only wanted a return on their investment. Professor Manne rebutted Professors Berle and Means's thesis that shareholders were left out of control of the corporations in which they had invested by saying there was no reason that ordinary shareholders would or should expect to have any right of control over the corporation. Professor Manne's fundamental contribution was that shareholders are merely capital providers, not discretion-wielding entrepreneurs. Professor Manne's explanation greatly influenced the later work of Professors Frank Easterbrook and Daniel Fischel, as he argued that the legal structure of large, public corporation law reflected the economics of specialized managers deploying capital from investors not particularly interested in management anyway.[80]

Then-Professor Easterbrook[81] and Professor Fischel's series of articles, and later book, represented the summation of the impact of all the economics work on the law and had the profound effect of fully establishing the "contractarian" view of the corporation. Professors Easterbrook and Fischel argued that the peculiar economics of collective business activity resulted in a corporate law that accurately reflected those economics and that this result was normatively good.[82] Consistent with their contractarian view, Professors Easterbrook and Fischel also contributed the most thorough argument that corporate legal rules should be default rules. The default rules, in turn, should be discerned from what a majority of participants in markets for corporate shares would want and that mimicked that market's selection of contract terms.[83] Professors Easterbrook and Fischel

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[78] Henry G. Manne, *Our Two Corporation Systems: Law and Economics*, 53 VA. L. REV. 259, 264 (1967).

[79] Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110, 112 (1965).

[80] Manne, *supra* note 78, at 261.

[81] Later, Professor Easterbrook would become Judge Easterbrook.

[82] *See* EASTERBROOK & FISCHEL, *supra* note 5, at 4. Professors Easterbrook and Fischel and Professors Alchian and Demsetz naturally found substantial influence in the earlier work of Professor Henry Manne. *See supra* text accompanying notes 79–80.

[83] EASTERBROOK & FISCHEL, *supra* note 5, at 15.

bridged the economics to the law, ultimately concluding, as Professor Manne had, that the law reflected the economics.[84]

Among the strongest modern contributions to the contractarian view of the firm is Professor Stephen Bainbridge's "director primacy" model. Professor Bainbridge's work squared a rather stubborn circle in corporate law: Why, if the shareholders were to be the privileged class in corporate law, do courts give so much discretion to directors and managers? Shouldn't shareholder wealth maximization imply greater shareholder power?[85] Of course, Professors Easterbrook and Fischel concluded, consistent with Professors Jensen and Meckling and others, that this was economically efficient. Professor Bainbridge, though, mapped this directly onto the law, describing the intricate statutory and doctrinal connections that reflect the economically efficient separation of ownership and control.[86] While the ends of corporate governance could be to ensure shareholder wealth, the means of doing so—as Professors Jensen and Meckling illustrated—was to vest power in an entrepreneur with command-and-control authority, as Professor Coase first observed. In the Delaware corporation, the entrepreneur is the board.[87] Consistent with this legal model, Professor Bainbridge has also done some of the most incisive work on majoritarian default rules and hypothetical bargaining.

Often, shareholder wealth maximization is defended on the grounds of the hypothetical bargain.[88] Likewise, the economic theory of default rules is that they are divined by reference to what a majority of people would want if they lived in a frictionless world with unlimited time, capacity, and resources to bargain.[89] This is also sometimes referred to as the "hypothetical" bargain. Along with the hypothetical bargain comes the notion that a majority of bargainers bargaining over the same term would reach a certain, efficient term. A further extension of

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[84] *Id.*

[85] Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 452–53 (2001).

[86] Bainbridge, *supra* note 32, at 559, 572–73; *see also* Williamson, *supra* note 31 (the board of directors is a special-purpose vehicle for managing the contract between the residual claimants and the corporation).

[87] Stephen M. Bainbridge, *Why a Board? Group Decisionmaking in Corporate Governance*, 55 VAND. L. REV. 1, 4 (2002). The board, likewise, serves Professors Fama and Jensen's monitoring function. *See* Fama & Jensen, *supra* note 72, at 303.

[88] Bainbridge, *supra* note 21, at 1430.

[89] *Id.*

this theory is that actual bargains may reflect the appropriate default term and that evidence of majoritarian default suitability should be obtained by such observation, whether those bargains were "outcome" only observations or come with evidence of the parties negotiation over the term.[90] At minimum, it would appear, shareholder wealth maximization might be thought of as the default corporate purpose under the law-and-economics, hypothetical bargaining model of the corporation.[91]

B. Other Models

1. Shareholder Primacy

Shareholder primacy is not an alternate model to shareholder wealth maximization, as it holds that shareholders are the privileged class in the corporation. As Professor Bainbridge describes, shareholder primacy and director primacy serve the same end: the maximization of shareholder wealth. Shareholder primacy, though, tends to reach back to Professors Berle and Means, suggesting that greater shareholder power is necessary to truly give effect to shareholder wealth maximization. Professor Lucian Bebchuk is the most prominent shareholder primacy advocate, and his work reflects a view not necessarily in tension with shareholder wealth maximization, but rather with how to get there.[92] Taking up the challenge from Berle and Means, who ultimately thought that great managerial authority within the corporate form would result in the shareholders' wealth never being maximized, Professor Bebchuk's proposed reforms aimed at giving shareholders more actual control through more substantial voting rights, director independence, and other shareholder control devices.[93] Contrary to Professor Bainbridge, Professor Bebchuk proposes that shareholders themselves, rather than managers and directors, are in a better position to turn their own interests into corporate policy, especially where managers are using their power to feather their own nests or consume other private benefits of control.[94]

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[90] *Id.* at 1428–29.
[91] *See* Mocsary, *supra* note 28, at 1342.
[92] *See* Bebchuck, *supra* note 45, at 838.
[93] *Id.* at 836–37.
[94] *Id.* at 898–99, 911–13.

2. Team Production

Distinguished from Professors Alchian and Demsetz, who referred to the firm as a model of team production, Professors Margaret Blair and Lynn Stout developed what is now known as the "team production" model of corporate law. In that model, the board is a "mediating hierarch" that connects and manages all of the factors of production needed for the team production. According to Professors Blair and Stout, Professors Alchian and Demsetz's analysis stopped short of a very important question about the nature of team production: How does it grow, change, or recede over time?[95] Moreover, how should the firm account for firm-specific investments in human capital? The answer to these questions, and others, led Professors Blair and Stout to conclude that corporate purpose, as executed by the board as mediating hierarch, was to find the best and most efficient way to produce whatever goods or services the corporation was producing, rather than serving shareholders—or anyone else, for that matter. The unique and searing insight is that corporations need not be run in the interest of any one constituent to be run well; they just need to be *run well*.

3. Multi-Fiduciary or Stakeholderist

The multi-fiduciary stakeholderist model originated with Professor E. Merrick Dodd's response to Professors Berle and Means, but it largely caught literary fire among scholars of management.[96] The normative claim is that all "stakeholders" have intrinsic value to the corporation and therefore are worthy of management's consideration.[97] As Professor Ronald Green put it, when contrasting the stakeholder model with the prevailing shareholder wealth maximization model, "[t]he difference will become apparent whenever corporate decisions arise in which acting on moral, as opposed to legal, responsibilities to other constituencies *cannot readily be justified in terms of long-term shareholder gain*."[98]

This fundamental idea is foundational to the more political theories of CSR and ESG. It likely underpins, for example, 2020

[95] Blair & Stout, *supra* note 41, at 275.

[96] *See generally* Thomas Donaldson & Lee E. Preston, *The Stakeholder Theory of the Corporation: Concepts, Evidence, and Implications*, 20 ACAD. MGMT. REV. 65 (1995).

[97] *Id.* at 67.

[98] Green, *supra* note 22, at 1419.

United States presidential candidate Elizabeth Warren's plan to create a federal chartering system for very large corporations.[99] It certainly motivated the Business Roundtable's late-2019 statement that signatory CEOs would be sure to keep stakeholders in mind when making corporate decisions.[100] It is not entirely clear whether the Roundtable meant that CEOs would do so because that is best for the shareholders in the long run, or, as Professor Green prescribes, would do so even when it is not best for the shareholders.[101]

Team production, stakeholderist, and modern social responsibility initiatives reject shareholder wealth maximization, whether on legal, moral, or economic grounds.

C. *Doctrine:* Dodge*,* eBay*, and Whether Shareholder Wealth Maximization Is a Binding Legal Principle*

Shareholder wealth maximization as a matter of *law* is complex. Several scholars have recently tried to put together the sparse case law with statutes and other sources of corporate operational law in a rigorous effort to link all these sources of corporate law to the shareholder wealth maximization norm.[102] Unavoidably, the doctrine leaves these scholars a bit wanting for a good definition of shareholder wealth maximization, how it is implemented, whether it is of mandatory legal force, and if it is, what the law actually requires. This Section tours the seminal cases, blending in some of this recent work and how it interacts with the cases.

The seminal case on shareholder wealth maximization is *Dodge v. Ford Motor Co.*,[103] a 1919 decision of the Michigan Supreme Court. It held:

> 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,

[99] *Accountable Capitalism Act*, ELIZABETH WARREN (Dec. 13, 2018), https://www.warren.senate.gov/imo/media/doc/Accountable%20Capitalism%20Act%20One-Pager.pdf [https://perma.cc/X3GA-QBJW].

[100] *See* Gellas & Yaffe-Bellany, *supra* note 26.

[101] *Cf.* Bainbridge, *supra* note 21, at 1433.

[102] *See, e.g.*, Heminway, *supra* note 51.

[103] 170 N.W. 668 (Mich. 1919).

> or to the nondistribution of profits among stockholders in order to devote them to other purposes.[104]

The dispute in the case involved whether Henry Ford, as a director of the Ford Motor Company, had violated his fiduciary duties by retaining the corporation's substantial earnings instead of distributing them to shareholders.[105] Part of Ford's rationale was that he intended, basically, to continue growing the business.[106] Another part involved lowering the prices of Ford automobiles and otherwise running the business as, according to the court, "a semi-eleemosynary institution and not as a business institution."[107] The court permitted what it apparently viewed as a legitimate business expansion, but sought to chasten Ford in his vision of a corporation run for the good of the "general public" or "to benefit mankind at the expense" of the stockholders.[108] Also notable, the court in dicta proposed that it would have permitted a number of actions that seemed to enrich other stakeholders.[109] It gave the example of permitting Ford to build a hospital solely to treat sick and injured Ford employees, which, naturally, would result in a great expenditure of the surplus that the court ultimately ordered to be distributed to the Dodge brothers and the other shareholders.[110]

Dodge has been subject to scholarly criticism and alternative interpretation. Professor Stout's admonition to corporate law professors, "Why We Should Stop Teaching *Dodge v. Ford*," is the best reflection of the criticism of *Dodge*. For starters, Professor Stout notes that the language quoted above is only dicta, undermining any claim that *Dodge* accurately reflects a principle of corporate law.[111] *Dodge*'s second major strike is that courts rarely enforce a purpose of wealth maximization directly and often expressly permit directors to make decisions that have a dubious or contrived relationship to shareholder wealth. The same goes for corporate charters and statutes. Finally, Professor Stout

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[104] *Id.* at 684.
[105] *Id.* at 670–71.
[106] *Id.* at 671.
[107] *Id.* at 683.
[108] *Id.* at 684.
[109] *Id.* at 683–84.
[110] *Id.* at 684.
[111] Stout, *supra* note 39, at 167–68. Professor Stout also categorizes *Dodge* as weak precedent because of its age and the fact that it was decided outside Delaware. The holding of the case, according to Professor Stout, essentially is that Henry Ford, as a controlling shareholder, oppressed the Dodge brothers, thus violating the duty the controller owes the minority. *Id.* at 166–68.

rejects the economic basis of shareholder wealth maximization, suggesting that privileging shareholder wealth reduces the relative value of debt claims, chills non-shareholder contributions to team production, and produces externalities to non-shareholder constituencies. Professor Stout's rejection of *Dodge* perhaps suggests it is more avatar than doctrine—that is, to the extent shareholder wealth maximization is or is not the law, *Dodge* is "weak precedent." Her arguments against *Dodge*, whether it is conceived of as avatar or precedent, represent a substantial criticism of shareholder wealth maximization itself.

As Professor Stout noted, at the time *Dodge* was decided, Delaware had not clearly stated as its law that shareholder wealth maximization was the mandatory or even default corporate purpose.[112] This would largely change a few short years later, when the Court of Chancery decided *eBay Domestic Holdings, Inc. v. Newmark*.[113] There, the Court faced a dispute over several defensive measures Craig Newmark and James "Jim" Buckmaster had taken to preserve their control over the corporate future of Craigslist, Inc. Echoing Henry Ford, Craig and Jim "prove[d] that they personally believe[d] craigslist should not be about the business of stockholder wealth maximization."[114] The Chancellor concluded that this was impermissible, articulating the norm as follows: "[D]irectors are bound by the fiduciary duties and standards that accompany [the corporate] form. Those standards include acting to promote the value of the corporation for the benefit of its stockholders."[115] Perhaps former Justice Strine of the Delaware Supreme Court put it most clearly when he called for a "clear-eyed" acceptance of the norm as the law.[116]

D. *Why a Renegotiation of the Norm Now?*

At one time, some thought that shareholder primacy (at least as an end of corporate governance, if not necessarily predicting a means) had reached the end of its history.[117] To the extent this

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[112] *Id.* at 169.

[113] 16 A.3d 1, 34 (Del. Ch. 2010).

[114] *Id.*

[115] *Id.*

[116] Strine, *Dangers of Denial, supra* note 29, at 761, 768.

[117] *See generally,* Hansmann & Kraakman*, supra* note 85 (discussing the forces driving the emergence and establishment of the shareholder-oriented model as the "standard model" for corporate governance across jurisdictions).

primacy-framed end is co-extensive with shareholder wealth maximization, it leaves one wondering why shareholder wealth maximization is again an object of public criticism and debate. One possibility is just that societies change over time, and whatever moment in time that gave rise to and preserved shareholder wealth maximization is now simply passing on.[118] Another possibility is that the downstream justifications are weakening a bit, as no one can come to a consensus on the optimal organization of the corporation in the first place. As Professor Bainbridge aptly noted a number of years ago, the law-and-economics scholars who contributed so much to corporate law and doctrine and those holding onto hope of drawing back on those contributions are simply talking past one another.[119] Finally, as has happened before, mainstream politics is taking seriously the economic and social power that has accumulated in very large corporations. Some have expressed concern that this economic and social power has inured only to the benefit of these corporations' managers, directors, and shareholders and therefore is suspect. Similarly, others focus on the potential for corporations to use their powers for the greater good of all constituents, rather than just the good of those who happen to own shares.

This Article purposely avoids taking positions on these debates, whether the academic one about the nature, provenance, or desirability of shareholder wealth maximization or the public one about managing corporate power and influence. Instead, since both tend to grapple with the meaning, consequences, and potential for reform of shareholder wealth maximization, I hope to contribute to the understanding of how the norm works. To that end, this Article presents shareholder wealth maximization as a Schelling point: an intuitive and objective norm that permits productive coordination of economic actors by getting everyone on the same page.

III. COORDINATION GAMES, SCHELLING POINTS

Economist Thomas Schelling was the first to conceptualize the focal point, and the concept bears his name in common

[118] *See, e.g.*, Lipton, *supra* note 21, at 867–70 (describing that shareholders are no longer quiescent and disengaged).

[119] Stephen M. Bainbridge, *Community and Statism: A Conservative Contractarian Critique of Progressive Corporate Law Scholarship*, 82 CORNELL L. REV. 856, 859–60 (1997) (reviewing PROGRESSIVE CORPORATE LAW (Lawrence E. Mitchell ed., 1995)).

vernacular.[120] He developed it from a strategy he and traveling companions used to find each other when they might have been separated.[121] Everyone agreed that if anyone got lost anywhere the party traveled, they would always find each other at the city's town hall, police station, or post office.[122]

Professor Schelling also occasionally tested the New York City game repeated in this Article's introduction on his students, finding often that important landmarks and intuitively selected times coordinated his students.[123] More than a simple game, Professor Schelling viewed this as a way that people coordinate their activities, so to reap gains from that coordinated action.[124] There is little legal scholarship on whether Schelling points shed any light on law, but the work that has been done is intriguing.[125] For example, Professor David Friedman uses the concept as a foundation for his work, "A Positive Account of Property Rights," arguing that focal points provided a useful theoretical explanation for the existence of property rights, which in turn gave rise to the ability to contract over them.[126] Additionally, Professor Robert Ahdieh aptly argued that boilerplate terms become focal points that contracting parties can use to obtain strategic bargaining leverage, thus divorcing the use of the boilerplate term from its actual meaning and has described the regulatory state as a source of coordination points.[127]

A. Coordination Games

A "coordination game" is a game theory concept where players in an experiment must coordinate with one another to obtain prizes. A pure coordination game is one without any conflict.

[120] *See Interview: Thomas Schelling*, REGION FOCUS, Spring 2005, at 36, 36; *see also* SCHELLING, supra note 1, at 57, 111.

[121] *Interview: Thomas Schelling*, *supra* note 120, at 36–37.

[122] *Id.*

[123] *Id.*; *see also* SCHELLING, *supra* note 1, at 55–56, 55 n.1.

[124] SCHELLING, *supra* note 1, at 55–58.

[125] *See generally* Richard H. McAdams, *A Focal Point Theory of Expressive Law*, 86 VA. L. REV. 1649 (2000) (describing and evaluating the role of legal rules and institutions in generating focal points).

[126] Friedman, *supra* note 13, at 15–16.

[127] Ahdieh, *supra* note 12, at 1037. Professor Ahdieh also proposed that boilerplate terms saved on transaction costs, though Professor Ahdieh's article separates this from the Schelling point analysis. *See* SCHELLING, *supra* note 1, at 67–68 (explaining that people often use past transactions as a framework for future ones); *see also* Robert B. Ahdieh, *The Visible Hand: Coordination Functions of the Regulatory State*, 95 MINN. L. REV. 578, 598 (2010) (describing the regulatory function as a producer of coordination points).

For example, the New York game show example at the beginning of this Article is almost pure coordination. That is, each party wins a declared prize where the total surplus is already split.[128] Other coordination games have a conflict component, usually over how to split a given surplus.[129] As Professor Ahdieh explains, all contract bargaining can be viewed as a coordination game with a varying degree of embedded conflict.[130]

Coordination games often have multiple—perhaps even very many—equilibria. To coordinate, the parties must choose one. Sometimes the payoff is the same regardless of which one they choose, but other times the payoff might be less if they pick the "wrong" one. Critically, though, that payoff might be greater than zero. A Schelling point that results in greater than zero net[131] value from coordination might not be optimal, as there could be another equilibrium with yet greater value. Even so, the sum of the value that does exist at the Schelling point and the avoidance of whatever costs might have been expended to achieve the optimum being greater than zero suggests a mutually and socially beneficial exchange, even if it isn't the best possible exchange. This, perhaps, often reflects the real world.[132]

B. Transaction Costs

In any game with multiple coordination points, there are three types of transaction costs: the costs of selecting the equilibrium, the costs of implementing it, and the costs of bargaining over the first two. For example, in the New York City game,[133] the parties have to choose a point of coordination and then will have to expend costs to get from their locations to the Empire State Building via taxi, rideshare, or perhaps the subway. In the

[128] Cooter, *supra* note 7, at 4. A true pure coordination game would involve the parties sitting across a table from one another already, trying to divide a dollar bill or pick a common square. The New York City example admits of the possibility that there is some conflict about whether to meet closer or further away from one party or the other. *Cf.* SCHELLING, *supra* note 1, at 58–59.

[129] Friedman, *supra* note 13, at 5–6 ("It is in *my* interest . . . ." (emphasis added)).

[130] Ahdieh, *supra* note 12, at 1039–40, 1051.

[131] The value at the Schelling point will also include a reduction in bargaining costs. *See* EASTERBROOK AND FISCHEL, *supra* note 5, at 34–35 (describing the economizing effect of legal default rules).

[132] *See* Jensen & Meckling, *supra* note 50, at 332, 352 (describing how real-life firm structures reflect the economic benefits, costs, and tradeoffs that exist in the real world).

[133] *See supra* Part I.

tacit version of the game, where the parties cannot communicate, the cost of selecting the equilibrium is extremely high and there are no bargaining costs because there can be no bargaining. The cost of implementing the Empire State Building solution might be greater than selecting the equidistant point between them, but due to the high costs of consciously choosing the point of coordination, there is no way to reduce them. Such costs do not necessarily evaporate with full communication, and new costs emerge. Perhaps the parties would then bargain over the meeting point and that bargaining would include considerations of each side's starting location. In this case, choosing a Schelling point reduces the *bargaining* costs.

Similarly, in some games, the only solution is for one side to expend more resources to obtain the nominal prize. Professor Schelling's example is a game where two soldiers parachute into a remote location, but their communication is limited by the fact that one soldier's walkie-talkie is only able to transmit whereas the other is only able to receive. In that case, the typical person playing the game as the receiving player will grudgingly solve the game by agreeing that she will make the trek to the location of the transmitting player who, of course, can transmit her position to the receiving player.[134] One player expends minimal transaction costs, while the other expends much more. These scenarios illustrate how Schelling points represent workable, but perhaps suboptimal, solutions. And that sometimes workable, suboptimal solutions are superior to no solution at all. In tacit bargaining, the Schelling point solves the insurmountable problem of *literally* not being able to agree on the coordination point. In explicit bargaining, it can solve the problem of avoiding the costs of continued or deadlocked bargaining.

C. Multiple Equilibria

A Schelling point is useful if there is more than one potential solution to a game. That is, there are multiple equilibria. Suppose a person is buying a car from a dealership. The dealership wants to achieve the maximum purchase price, while the buyer wants to achieve the minimum. The most the buyer will pay is $20,000 and the least that the dealership will accept is $18,000. If the buyer was aware of the dealership's price and could

[134] SCHELLING, *supra* note 1, at 59.

credibly communicate firmness of her offer,[135] she could just offer $18,000 when she walked in the door and leave with the car. If the dealership was aware of the buyer's price and could credibly communicate firmness of its offer, the salespersons would offer her the car for $20,000 and she would take it and leave with the car. Thus, there are equilibria anywhere from $18,000 to $20,000 where the parties would strike a mutually beneficial deal. This is the surplus that must be divided for the transaction to occur. From a wealth perspective, any dollar less than $20,000 is increased wealth for the buyer and any dollar over $18,000 is increased wealth for the dealership, but regardless of the division of the wealth, total wealth is the same.

What would you expect to happen? Given two serious buy/sell offers of $18,000 and $20,000, and since neither side can credibly communicate the firmness of its offer, the most common outcome is likely that the two parties would "split the difference" and make a trade at $19,000.[136] This is what Professor Schelling's theory would predict—the number equally between the two bounds is the natural endpoint where both sides are happy but not worrying about whether either ceded too much surplus to the other.

Of course, that does not have to be true. Each of the parties could still work to obtain a bigger slice of surplus residing between the equilibria—that is, they could expend more bargaining costs.[137] What if the dealership were struggling financially and could use the extra money? What if the buyer were less wealthy than the dealership owner and the marginal value of each extra dollar had greater utility to her than the owner? This might suggest that, from a utility or wealth perspective, relatively greater utility might exist if one party or the other obtained more of the surplus, even though the total wealth is the same. Similarly, the parties may dig in, and expend more transaction costs to either arrive at—or not arrive at—a different equilibrium.

Professor Robert Cooter explained that sometimes the point at which mutually beneficial cooperation will or will not occur is a factor of being unable to bargain to an agreement over the surplus.[138] Professor Cooter argued this was true regardless of

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[135] This is important because, in reality, both sides have reason to believe the other is bluffing about the firmness of the offer. Friedman, *supra* note 13, at 6.

[136] *See* SCHELLING, *supra* note 1, at 67.

[137] Cooter, *supra* note 7, at 17, 20–21.

[138] *Id.* at 4.

transaction costs and even argued that reducing transaction costs could have the perverse incentive of leading the parties to play chicken over the division of the surplus past the point where cooperation could be reached.

But what Professor Cooter was not seeking to address is how these bargains actually get done when they do get done. The last step—the piece of the puzzle that solves the problem—is the Schelling point, which very often is "split[ting] the difference."[139] Again, it is not necessarily the logical outcome, and in fact may be logically irrelevant. That is, splitting the difference does not naturally split the surplus fairly or optimally. *It just splits the surplus*. Numerous optimizations could all be constructed into a precise model—or the parties, facing the costs of continued bargaining or losing the deal altogether, could just settle on $19,000, a number both parties intuitively understand as both increasing their utility and receiving a fair deal.[140]

D. The Power of the Focal Point—Contextual Intuitiveness

Professor Schelling argued that this phenomenon of bargaining behavior was more than a quirk or random element of human conduct. His own informal experiments, and several others since, illustrate the unusually high likelihood that people can and will solve coordination problems without the aid of communication and that this extends to circumstances where people can literally communicate, but cannot *effectively* communicate sincerity or firmness.[141] In the example above, it is obviously in the car dealership's interest to convince the buyer that it will not sell the car for less than $20,000, even though this is not true, so the buyer simply might find the salesperson's claim that it will not sell the car for less than $20,000 unbelievable. The same is true of the buyer—the dealership simply might disbelieve her claim that she will not pay more than $18,000. A small move by either party will fail to communicate credibility, because both parties will again conclude the other is not telling the truth. Small moves in either direction suffer from the same issue. If the dealer simply knocks off another $500 and says "best and final," the

[139] SCHELLING, *supra* note 1, at 67.

[140] It is also possible that this just does not happen, but that does not undermine the observation that it must happen quite often. *See* Donald J. Boudreaux, *The Coase Theorem and Strategic Bargaining*, *in* 3 ADVANCES IN AUSTRIAN ECONOMICS 95, 101 (Peter J. Boettke & David L. Prychitko eds., 1996).

[141] Friedman, *supra* note 13, at 5–6.

buyer may simply add $500 to her offer and also say "best and final," arguably signaling her disbelief that the dealer's offer was not actually its best and final, but failing to signal that her new offer was *her* best and final. This, of course, costs the parties more in bargaining costs. Professor Schelling's solution is that if there is a focal point in the bargain, this point is where the parties can conclude it.[142] In this sort of bargain, splitting the difference between the most recent two "serious" offers usually gets the deal done.[143] Perhaps there indeed was a little bit more value in either direction—the dealership could have squeezed a bit more from her or she from it, but the "split-the-difference" model stands out in everyone's mind as at least generally "fair."

IV. THE SHAREHOLDER WEALTH MAXIMIZATION NORM IS A SCHELLING POINT FOR COORDINATING DIVIDED OWNERSHIP OF EQUITY INTERESTS IN BUSINESS ASSOCIATIONS

Bargaining within the context of the public corporation is cost-prohibitive.[144] In fact, it is not exactly cheap in the non-public context either. These transaction costs, were they to be incurred, might wash the prospect of a deal at all. So, parties simply do not incur them.[145] Instead, they simply do not select terms and just go into business together on the basis of trust, unspoken understanding, or just bare incomplete terms.[146] Since the law-and-economics revolution in corporate law, commentators have proposed that the corporate law should provide off-the-rack default terms to complete corporate contracts, so that when the corporate bargainers choose to forgo transaction costs, there will be a clear legal rule for resolving any dispute that might arise later.[147] Such an approach likely reflects Delaware law and the law in most other states.[148] Commentators have long justified these off-the-rack default terms as the predicted or observed outcomes of hypothetical or actual

[142] SCHELLING, *supra* note 1, at 70.

[143] *Id.* at 111.

[144] Bainbridge, *supra* note 21, at 1427–29; *see also supra* Part I.

[145] Ahdieh, *supra* note 12, at 1071; *see* Robert Anderson & Jeffrey Manns, *The Inefficient Evolution of Merger Agreements*, 85 GEO. WASH. L. REV. 57, 61–62 (2017) (contesting the notion that business transaction drafting is the result of "distinctively crafted" final documents).

[146] Donahue v. Rodd Electrotype Co. of New England, Inc., 328 N.E.2d 505, 515 (Mass. 1975).

[147] *See supra* Section II.A.

[148] *See supra* Part II.

bargains, justifying the legal system's application of such default terms as carrying out a majoritarian preference.[149] That is, as the process unfolds, efficient rules will be revealed as parties contract around the default rules, or do not contract around them.[150] Such an explanation is a very good one for why courts should enforce default rules instead of mandatory rules and is generally a good fit for the idea that corporations are voluntary associations of private individuals pursuing private ends, but critics have argued that some default rules may still be suboptimal.

This version of law and economics is very persuasive, but so have been very thoroughgoing critiques.[151] Schelling point theory is not so easy to undermine, in part because it rests less on the assumptions commonly needed to model allocative efficiency and at least implicitly concedes that the outcomes may not be the optimal outcomes. Instead, Schelling point theory suggests that being a part of the corporate bargain that exists under an arguably suboptimal shareholder wealth maximization regime is superior to not participating in the corporate bargain at all.[152] Schelling point theory explains why, within the context of business associations, so many people can coordinate to found and run so many business ventures without being overwhelmed by transaction costs.[153]

This Part describes the process of coordinating capital investments from large numbers of dispersed and rationally uninformed investors, the transaction costs associated with that process, and the multiple equilibria that can be reached within it. This Part presents this Article's core argument: shareholder wealth maximization is persistent because it permits coordination at a productive equilibrium and minimizes transaction costs due to its objective and intuitive fit within the corporation context.

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[149] EASTERBROOK & FISCHEL, *supra* note 5, at 20–22.

[150] *Id.* at 21–22.

[151] *See supra* Section II.A.

[152] *Cf*. Theodore N. Mirvis, Paul K. Rowe & William Savitt, *Bebchuk's "Case for Increasing Shareholder Power": An Opposition*, 120 HARV. L. REV. F. 43, 44–45 (2007) (discussing the extent to which the United States corporate governance system has "performed admirably").

[153] As Professor Mocsary argued, the corporate form itself could be described as a Schelling point. Mocsary, *supra* note 28, at 1338 & n.94.

A. *Coordinating Capital and the Production of Goods and Services*

Large corporations exist because it often takes a large amount of organized resources to undertake long-term and very expensive projects.[154] These long-term projects take a lot of money, which is locked in over a long period of time.[155] Almost no individual corporate manager or director, or any other individual person, has enough capital to contribute in this manner. Even if an individual person did have enough capital, most people diversify their holdings and will not put all of their money into a single large enterprise.[156] Likewise, single banks typically do not commit that level of capital to a single loan, either, as they must diversify lending risk in the interest of their own shareholders—not to mention depositors.

One possibility is to conduct all necessary activity for the production of all goods and services in person-to-person transactions in spot markets, but, as Professor Coase recognized, this is not feasible.[157] Another possibility is for small groups of people who *can* communicate and coordinate easily to undertake projects by pooling their capital.[158] This may not always scale to the level needed to conduct such complex activities as cracking petroleum for ethane or manufacturing commercial aircrafts.[159] Thus, large corporations exist, and they simply must accumulate capital at a rate that requires dispersed public investment of some kind.

Notably, a "bond" is a specific type of financial contract, the basic terms of which are well-understood.[160] Another way, as Professor Ronald Gilson once described as the mode of corporate

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[154] Coase, *supra* note 55, at 396–97; Blair & Stout, *supra* note 41, at 322; ADAM SMITH, 2 AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS 278 (George Bell & Sons ed. 1908) (1776).

[155] *See* Stout, *supra* note 18, at 1194; *see also* Lynn A. Stout, *The Corporation as a Time Machine: Intergenerational Equity, Intergenerational Efficiency, and the Corporate Form*, 38 SEATTLE U. L. REV. 685, 685–86 (2015).

[156] *See* Alchian & Demsetz, *supra* note 56, at 779, 787–88.

[157] Coase, *supra* note 55, at 387–89.

[158] This is the traditional partnership or close corporation model.

[159] This is not to say private companies with a large geographic footprint and high revenues cannot function without dispersed public investment, but even private investment pools obtain capital at some point in the financing chain from more than a single person. For example, private equity firms obtain capital from a smaller number of wealthier investors.

[160] It is a transaction-cost-reducing innovation that allows corporations to accumulate capital from dispersed investors.

operation in Germany and Japan, is to fund large corporations with equity capital mostly from banks, which have their own engaged managers.[161] These banks, of course, accumulate capital in the form of deposits and other more conservative individual investments.[162]

Corporations simply must accumulate a large amount of capital and American corporations have typically pursued capital from many dispersed individual investors.[163] With a broad pool of direct investors, transaction costs begin to emerge on both sides of the deal. The transaction costs of selling equity—at least in the manner conducted in the United States—are dealt with, in part, through the shareholder wealth maximization norm.

1. Transaction Costs

Within the corporate contract, directors and managers acting on behalf of the corporation and investors deciding whether to purchase shares face transaction costs. On the corporation side, directors have to construct a bundle of economic and control rights to appeal to investors. In non-public corporations, directors, who are often founders and entrepreneurs, can bargain with potential investors face-to-face over various economic and control rights. Directors, upon choosing to offer shares to the public at-large, can no longer bargain face-to-face with investors.[164] Without the ability to actually bargain over terms and conditions of share ownership, the directors and managers have to make guesses at what the public wants, and make that the bundle of economic and control rights they will offer to public investors. Corporate finance practice has settled on a share of common stock as having a set of typical economic features, including, for example, the residual claim and potentially sometimes dividends.[165] Different firms may offer different bundles of rights for

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[161] Ronald J. Gilson, *Corporate Governance and Economic Efficiency: When Do Institutions Matter?*, 74 WASH. U. L.Q. 327, 327–28 (1996).

[162] Mark J. Loewenstein, *Stakeholder Protection in Germany and Japan*, 76 TUL. L. REV. 1673, 1678–79 (2002).

[163] Nonetheless, "institutional investors" such as pension funds, mutual funds, and other investment vehicles own a large percentage of the current equity market capitalization.

[164] Green, *supra* note 22, at 1411–12 (criticizing the hypothetical bargain methodology); *see also* Utset, *supra* note 23.

[165] *See* EASTERBROOK & FISCHEL, *supra* note 5, at 10–11, 36–37 (discussing the nature of "stock" and the ways that different governance terms emerge from firms experimenting with them).

various reasons—for example, dual-class stock[166]—but the convergence is striking.[167] The feature the directors and officers rarely fail to offer is shareholder wealth maximization as a fundamental norm—in fact, such a norm is the thing that makes the residual claim valuable.[168] Even if the *content* of shareholder wealth maximization is not always discernible or optimal, the communication from the managers and directors to the shareholders that they will be doing their best to maximize the shareholders' wealth is a commitment that has to be made.[169]

On the investor side, investors have to figure out what kinds of companies they want to invest in and what level of risk they are comfortable taking, and then also find out actual details about the company and its business. These are actions that many investors are rationally unwilling to take, both before and after making investments.[170] A bargain that consisted of "invest your money with us, the professional managers, and we will do whatever we want with it" would not be expected to earn much investment at all.[171] A complex bargain that rigidly promised a certain dollar amount of return per dollar invested, or the like, would be preferred stock or a bond which can be offered with lower transaction costs, but importantly, with financial returns limited by their terms.[172] Investors who invest in common stock simply would not, rationally, have any way to bargain with directors and managers over the terms of their relationship, nor would directors and managers find it worthwhile to do so.[173]

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[166] Zohar Goshen & Richard Squire, *Principal Costs: A New Theory for Corporate Law and Governance*, 117 COLUM. L. REV. 767, 806–07 (2017).

[167] EASTERBROOK & FISCHEL, *supra* note 5, at 36–37.

[168] *See* Alchian & Demsetz, supra note 56, at 789 n.14.

[169] *Cf.* Ahdieh, *supra* note 12, at 1037, 1062 (discussing how certain terms signal much more than their actual content).

[170] *See generally* James Martineau, *The Importance for Trustees To Understand Their Tolerance to Investment Risk*, 15 TRUSTS & TRUSTEES 626 (2009); *Cf.* Jeff Brown, *How Investors Can Check for Risk*, U.S. NEWS & WORLD REP.: MONEY (Dec. 10, 2018, 11:27 AM), https://money.usnews.com/investing/funds/articles/how-investors-can-check-for-risk [https://perma.cc/RV7R-VTXY] (exploring the difficulty of assessing interacting risks within a portfolio).

[171] Bainbridge, *supra* note 21, at 1441–43, 1443 n.72 (explaining that shareholders are not a bottomless tap of money for corporations to use for whatever purposes managers choose which is, of course, true due to market constraints to some extent, but also due to legal ones).

[172] This would not attract "optimistic" investors—or, at minimum, risk-takers—because the upside is limited. *See* Alchian & Demsetz, *supra* note 56, at 789 n.14.

[173] *Cf.* Bainbridge, *supra* note 119, at 870–71, 875–76 (providing the example of a take-it-or-leave-it contract for a rental car as an illustration of "outcome bargain[ing]").

If this were the whole story, then one would never have expected to see large corporations conducting so much business in the global economy.[174] Shareholder wealth maximization solves this problem because it is a Schelling point for both sides: directors, managers, and shareholders understand that maximizing shareholder wealth is a fundamental norm. Shareholders commit their existing wealth with the understanding that their future wealth will be maximized not due to choosing to take a particular amount in return—like a bond—but through the increase in the value of the firm that arises through the labor and efforts of the managers and directors oriented toward the goal of maximizing that value.[175]

Firms exist because organizing economic activity into firms solves some of the transaction-cost problems associated with bargaining large, costly, risky, and long-term projects, but it does not solve all transaction costs problems. Bargaining with the providers of equity capital is cost-prohibitive, so having a Schelling point reduces or eliminates those costs.[176] The firm, whether in the corporate form or in another business entity form, reduces transaction costs associated with hiring factors of production such as purchasing machinery and employing labor. Likewise, it lowers the transaction costs of obtaining credit.[177] But, since the firm uses a lot of equity capital, and trades it for the residual claim, there emerges a new set of transaction costs specific to the firm: agency costs.[178] Professors Easterbrook and Fischel, among others, observed that the public stock markets dealt quite well with these costs. The thesis of their economic analysis of the corporation was that equity markets would reward good managers and directors and punish bad ones.[179] In

[174] *Cf.* SMITH, *supra* note 154, at 26 (noting "division of labour" is limited by the "extent of the market").

[175] *See* Alchian & Demsetz, *supra* note 56, at 787–88; *see also* Letter from Warren Buffet, Chairman of the Bd., Berkshire Hathaway, Inc., to Berkshire Hathaway S'holders at 3–4, 11 (Feb. 22, 2020) (on file with author) (describing the "compound[ing]" nature of retained earnings).

[176] *See supra* Section III.B.

[177] Mocsary, *supra* note 28, at 1338 (describing the corporation itself as a Schelling point for gathering and deploying resources).

[178] *See supra* Section II.A. As Professors Goshen and Squire aptly argue, agency costs are not the only transaction costs associated with the relationship between shareholders, managers, and directors. Shareholder control devices can create "principal costs" which are also transaction costs embedded in the corporate contract. Goshen & Squire, *supra* note 166, at 770–71.

[179] That is, lower share prices suggest poor management, and higher share prices suggest better management, as market participants sold off stocks of poorly

that process, corporations would adopt the governance forms that best enabled them to sell stock, and corporations stubbornly insisting otherwise would sell less stock or see their prices fail to keep pace with the better-governed firms.

Professors Easterbrook and Fischel's analysis rests on the assumption that market prices reflect a level of conscious choice—which they do. The question is what is the conscious choice? Is it a choice based on all market participants individually pricing the substantive features of particular governance forms, or is it some, perhaps even many, market participants accepting a Schelling point that happens to contain those substantive features?[180] It is one thing to assume that shareholders are rationally ignorant but another thing to assume that rationally ignorant shareholders will make so many "good" choices through consciously weighing and balancing different substantive governance choices. The connection is the Schelling point. Where there are multiple choices, but no opportunity to bargain over them, the bargainers will choose the Schelling point. When corporate governance could consist of shareholder wealth maximization or some other purpose or purposes, shareholders and managers and directors will often, though perhaps not always, alight on the shareholder wealth maximization norm because it is the intuitive place to settle the bargain.

2. Multiple Equilibria

Corporate law is highly flexible and permits shares of capital stock to be designed with a dizzying array of rights and benefits.[181] In smaller corporations, it is entirely possible for the parties to construct a bespoke corporation that fits the needs of everyone involved.[182] In a large corporation with many investors, or with many shares of stock to potentially sell in a liquid market, coordinating this customization would be impossible. This does not mean, however, that multiple points of agreement would not be wealth-enhancing for the corporation and the shareholders alike.

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managed firms and bought up well-managed firms. This is also consistent with price theory's tenet that prices work like a communication signal—they contain information.

[180] *Cf.* Ahdieh, *supra* note 12, at 1037, 1053–55.

[181] Goshen & Squire, *supra* note 166, at 798–801, 805–10; *see also* MODEL BUS. CORP. ACT § 6.21 (AM. BAR ASS'N 2016); DEL. CODE ANN. tit. 8, §§ 151, 152 (West 2017).

[182] It is unclear whether smaller corporations actually do this.

As discussed above, scholars, not to mention courts, have struggled with how to manage divergent shareholder preferences.[183] Not every shareholder may desire the decision purported to maximize wealth because, for example, that shareholder's individual interests may be harmed separately.[184] Or, an investor may wish to maximize her overall utility from all of her investments, as opposed to maximizing her wealth from her investments in a number of individual firms.[185] But, as Professors Jensen and Meckling described, the corporate nexus of contracts is how the divergent individual preferences achieve equilibrium.[186] In the sense that Professors Easterbrook and Fischel developed, the law has developed processes and doctrines for coordinating the moves to or between equilibria.

Where there are multiple wealth-enhancing equilibria, a new transaction cost emerges: which equilibrium to choose. A corporate purpose of shareholder wealth maximization is a productive equilibrium, but this Article grants that stakeholderists and ESG/CSR proponents may have identified other ones and that several scholars have raised formidable questions about the future of wealth maximization in the traditional sense.[187] A corporate governance that takes into account, say, the impact of corporate decisions on climate change could even be a superior equilibrium compared to one that focuses on maximizing financial wealth of the shareholders as a class. The issue is that the shareholder wealth maximization equilibrium is relatively more visible, objective, and verifiable than these others. Similarly, it is more contextually intuitive. At this point, with a mature corporate law and governance, much of its contextual intuitiveness could be of the kind that Professor David Friedman described: it is the rule now because everyone knows it is and has been the rule.[188]

To some extent, shareholder wealth maximization is a creature of corporate law, but there is little reason to believe it does not apply in other entities in some form, and in all forms, there is some coordinating norm of going into business for the purpose of

[183] Lipton, *supra* note 21, at 865–67, 888.
[184] *Id.* at 866–67; *see also* Griffin, *supra note* 43, at 79–81.
[185] Heminway, *supra* note 51, at 944.
[186] *See supra* Part II.
[187] Heminway, *supra* note 51, at 970 n.89; Lipton, *supra* note 21, at 888.
[188] Friedman, *supra* note 13, at 2.

earning a profit for those who have gone into the business.[189] A simple example of a two-shareholder, close corporation, which many states treat more like a partnership,[190] represents a relatively low-transaction-costs environment where the two parties could actually consider the terms of their venture. However, many cases have arisen, and still arise, where the parties actually do not bargain over the terms of their relationship.[191] While this could be due to insufficient capital to hire attorneys, Professors Jeffrey Manns and Robert Anderson have illustrated that even parties with the means to hire attorneys to bargain over every term of their agreement simply do not do so.[192] In theory, if they did, it might be fair to infer that the bargain represented the precise desires of both parties and proof of the mutual benefit of the transaction.[193] In fact, the parties do not actually bargain in a literal or meaningful sense, but they still reach a deal.[194] Critics have taken this as substantial evidence that contractual principles cannot map precisely enough onto corporate law to be workable. Thus, a difficult and unsettled question arises about the efficiency, optimality, or wealth-enhancing nature of the choice.[195] One way that people have dealt with multiple equilibria and the lack of optimality is to choose the one that it is the most contextually intuitive—the Schelling point. Perhaps the right explanation for why corporate governance remains fixed upon shareholder wealth maximization

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[189] For example, the common law definition of a general partnership includes the elements of two or more people carrying on business together for a profit. UNIF. P'SHIP ACT § 101 (NAT'L CONF. OF COMM'RS ON UNIF. STATE L. 2019). Partners owe each other fiduciary duties, animated by the concept that all partners act for the interest of increasing the wealth of the partnership, of which the partners are entitled to equal shares. UNIF. P'SHIP ACT § 401(b) (NAT'L CONF. OF COMM'RS ON UNIF. STATE L. 2019).

[190] Donahue v. Rodd Electrotype Co. of New England, Inc., 328 N.E.2d 505, 510–11 (Mass. 1975) (citing Ripin v. U.S. Woven Label Co., 205 N.Y. 442, 447 (N.Y. 1912); Kruger v. Gerth, 16 N.Y.2d 802, 805 (N.Y. 1965)).

[191] *See, e.g.*, *Donahue*, 328 N.E.2d at 510–12, 515–17; Ritchie v. Rupe, 443 S.W.3d 856, 861–63 (Tex. 2014). *But see* eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 11, 19–20, 25 (Del. Ch. 2010) (Parties in a close corporation did in fact bargain with one another, but they ultimately disagreed and ended up in litigation over whether the corporation was going to maximize wealth or be a public service.).

[192] Anderson & Manns, *supra* note 145, at 61, 84–85 (discussing that sometimes changes lawyers make to documents seem to not even reflect conscious choices at all).

[193] *Cf.* Green, *supra* note 22, at 1413–14, 1418.

[194] Bainbridge, *supra* note 32, at 578–79.

[195] *See* Eric A. Posner, *Law, Economics, and Inefficient Norms*, 144 U. PA. L. REV. 1697, 1704, 1707 (1996); Lipton, *supra* note 21, at 879, 881.

is not because it is necessarily optimal, but because it is intuitive and workable.

B. Contextual Intuitiveness in Corporate Governance

Among the key insights about Schelling points are that they are contextually intuitive. When attempting a meeting at the Empire State Building, the parties objectively understand what it is—and, more importantly, *where* it is—and easily verify it as a meeting point. Within a game where the object is to meet in New York City, there are few places that capture the popular imagination like the Empire State Building.[196] This makes it a contextually intuitive—even poetic[197]—meeting place when the players have no way to discern any information about each other. Again, it is critical to emphasize that meeting at the Empire State Building is probably not optimal, and in fact, it is likely a clear case of a non-optimal equilibrium. It's not centrally located in New York City, and, depending on where the parties are starting, it might not be convenient to either of them.

Shareholder wealth maximization has a similar objectivity and contextual intuitiveness. As Professor Manne described it, the typical shareholder shows up to the corporate bargain after the entrepreneurial process has already started and perhaps has even largely been completed.[198] Shareholders provide investment capital—they do not have any reason to desire any control or responsibility. They simply want a return on investment. Managers and directors, having completed or greatly progressed in the entrepreneurship part, are looking for money. So, they offer to the potential shareholders the residual claim, along with the only available objective *and* contextually intuitive implied promise: to increase the value of that residual claim.

1. Objectivity and Verifiability of Shareholder Wealth Maximization

Schelling points are objective and verifiable points because anyone desiring to coordinate can observe them and thereby confirm their observability by others. So observed, people coordinate their activities and confirm coordination by observing others

[196] Granted, there is Times Square, Grand Central Station, or perhaps even Central Park.

[197] Professor Schelling noted that he expected poets would sometimes be better at his coordination games than logicians. *See* SCHELLING, *supra* note 1, at 58.

[198] *See* Manne, *supra* note 78, at 261.

locating themselves at the Schelling point—just as one can observe another person standing in front of the Empire State Building. Shareholder wealth maximization shares these features.

The notion that a business exists to make money, whether or not the same is desirable in all cases, is an objective concept.[199] Most people understand what it means to attempt to earn money from various business activities and that understanding is shared. Similarly, it is verifiable in that there are simple ways to measure whether the amount of money earned is increasing or decreasing. In public stock markets with quoted prices, the current capitalized value of a corporation's future value is, at least to some extent, verifiable in that price.[200] The price of any given fraction of the corporation's freely-traded residual claim reflects that fraction of the corporation's value to the market as a whole.[201]

To be sure, there are lots of metrics that might be objective and verifiable. Certainly, a corporation could disclose how much carbon it emits from its operating activities in tons, and any person—shareholder or otherwise[202]—who might be interested in that information would then be able to observe and verify it. This might make it an equilibrium and perhaps even an optimal point of corporate coordination. But there are costs associated with this. Are the metrics right? Do people truly find them useful?[203] Again, the benefits of Schelling points flow from their role in creating a choice where there are multiple equilibria and high transaction costs. What separates shareholder wealth maximization from other corporate purposes is its contextual intuitiveness. While it may be true, and perhaps even obviously so, that it would be good if corporations—and non-corporate actors—reduced their carbon emissions, it is not obvious why or how a corporate board of directors and its appointed managers would

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[199] *See* Mocsary, *supra* note 28, at 1382, 1384.

[200] *See* EASTERBROOK & FISCHEL, *supra* note 5, at 18, 20; Manne, *supra* note 78, at 266; Manne, *supra* note 79.

[201] EASTERBROOK & FISCHEL, *supra* note 5, at 19–20.

[202] Ann M. Lipton, *Mixed Company: The Audience for Sustainability Disclosures*, 107 GEO. L.J. ONLINE 81, 81 (2018), https://www.law.georgetown.edu/georgetown-law-journal/glj-online/107-online/mixed-company-the-audience-for-sustainability-disclosures/ [https://perma.cc/WQ8B-8PTN].

[203] *See, e.g.*, Eve Tahmincioglu, *SEC Chief Takes on Short-Termism and ESG*, DIRS. & BDS. (Jul. 22, 2019), https://www.directorsandboards.com/articles/singlesec-chief-takes-short-termism-and-esg [https://perma.cc/THT5-EMZR].

implement such a normative good as a purpose.[204] Corporate managers and directors have been implementing shareholder wealth maximization as a simple, intuitive corporate purpose for over a century.[205]

2. The Contextual Intuitiveness of Shareholder Wealth Maximization

Schelling points are contextually intuitive. People navigating a context with which they are at least somewhat familiar will gravitate toward points that "stand out" within the relevant context. As Professor George Mocsary describes, the Michigan Supreme Court in *Dodge* was merely stating expressly what everyone involved with business associations knew and understood intuitively: the purpose of the corporation is to make money and the directors and officers should be trying to make money.[206] It was apparently so ingrained in the fabric of the business world at the time that the *Dodge* court spoke of it as though it was obvious.[207]

It would be simple to imagine that shareholder wealth maximization reached this contextual intuitiveness *because of* the justifications that emerged from the law-and-economics movement.[208] That is, one could imagine early corporations maximizing shareholder wealth because it was efficient or because it was a majoritarian desire. But there's no reason to believe that early corporations and their predecessors were efficient or desirable at all.[209] As with modern large corporations, early large corporations existed to undertake large, costly, risky and long-term projects. Thus, they needed lots of capital and needed it from a larger pool of investors. They already had boards,[210] already paid dividends,[211] and already collected money from dispersed and

[204] *Cf.* Mocsary, *supra* note 28, at 1364–65 (distinguishing a corporation's tactical and strategic purposes).

[205] Sharfman, *supra* note 40, at 393–94; *see also* Mocsary, *supra* note 28, at 1382.

[206] Mocsary, *supra* note 28, at 1344.

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

[208] *See supra* Section II.A.

[209] Adam Smith, the "father" of modern free market economics and progenitor of the term "invisible hand," thought corporations were doomed to failure, unless they were granted a monopoly or were chartered to handle only "routine" tasks. SMITH, *supra* note 154, at 277; *see also* LOUIS D. BRANDEIS, OTHER PEOPLE'S MONEY AND HOW THE BANKERS USE IT 7 (1914); BERLE & MEANS, *supra* note 46, at 4.

[210] SMITH, *supra* note 154, at 253.

[211] *Id.*

largely disinterested investors.[212] Primarily due to the latter feature—dispersed and disinterested investors utterly failing to exercise any control—they were also thought to be of quite limited utility.[213]

As described above, economic theories of incentives would suggest an intractable problem: managers' and directors' incentives are to shirk and potentially steal, and to externalize corporate costs onto society, while shareholders' incentives are to remain rationally ignorant of shirking, stealing, or anything else managers and directors may be doing.[214] If shareholder wealth maximization is to persist, then, it must have economic value. As everyone from Professor Coase forward explained: the firm will work, or not, based on whether the increased productivity associated with doing things as a firm exceeds the costs associated with doing things as a firm.[215] Again, though, no individual shareholder can guess in advance, nor can any director or manager *credibly* commit in advance that she will be such a good director or manager that the firm's productivity gains will always exceed all relevant costs, including agency costs associated with having managers and directors. But since shareholders continue to invest, and managers and directors continue to permit public stock to be outstanding, there has to be some mechanism holding the things together: the Schelling point that is the shareholder wealth maximization norm.

Managers do not have any way to credibly communicate to the shareholders their intention to be good central contracting agents, and directors struggle to credibly communicate their intention, and ability, to be good monitors. Of course, all managers and directors will promise to efficiently run the corporation and not shirk or steal, but that promise is hardly believable in the abstract, because they have great incentive to shirk and steal and shareholders have neither the power nor incentive to police them.[216] Managers and directors may even be incentivized to oversell their ability to be loyal and competent, because then they would have an even better chance of escaping with ill-gotten

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[212] *Id.*

[213] *Id.* Professors Berle and Means echoed this concern separation, once again announcing doom for the widely-dispersed-shareholder version of the corporation. BERLE & MEANS, *supra* note 46, at 4–9.

[214] *See supra* Part II; BERLE & MEANS, *supra* note 46, at 45–46, 46 n.33.

[215] Jensen & Meckling, *supra* note 50, at 326.

[216] *Cf.* Manne, *supra* note 78, at 261.

gains. Yet again, a well-constructed hypothetical bargain grinds to a halt because there is no way to credibly communicate, there are information asymmetries, and it is really hard for the shareholders to exercise any true role in governance.[217] The surplus that might be created by striking the bargain is dependent upon all of these costs and benefits equilibrating.[218]

As a matter of description of the corporate landscape, the existing costs and benefits must have equilibrated somehow. The manner in which they do is measured by adherence to the Schelling point: everybody observes the norm that the managers' and directors' duties are to make their primary ends the increase in the value of the corporation, and therefore, the residual claim. Managers and directors *recognize* that this is what they are supposed to be doing, while shareholders *recognize* that this is what they should expect the managers and directors to do. The shareholder wealth maximization norm solves the coordination and conflict problems[219] and creates credibility for managers and directors promising shareholders to act in their financial interest.

3. Putting the Default in Default Rules

Borrowed from contract law, along with the nexus-of-contracts metaphor, contractarian corporate law proposes that corporate law is a set of off-the-rack default rules that the parties can change if they desire.[220] Private ordering is supposed to best permit the people with knowledge and information to put it to use in the most efficient ways in the market. The aggregation of these private choices, whether they are individually rational or not, underpin basic theories of economic efficiency and rational utility maximization.[221]

If the general idea of default rules is that they facilitate the efficiency gains of private ordering, then how should the rules be selected? The simple answer is that default rules should reflect what a majority of parties in the relevant space would want if they could costlessly bargain. While the law-and-economics schol-

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[217] Again, the hypothetical nature of the bargain allows the device to ignore these costs, but this Article's goal is to explain the results of the hypothetical bargain by illustrating how real bargains can overcome the impediments preventing the hypothetical ones.

[218] Jensen & Meckling, *supra* note 50, at 307–08, 311, 336.

[219] Ahdieh, *supra* note 12, at 1039.

[220] Bainbridge, *supra* note 32, at 578.

[221] *See* Gary S. Becker, *Irrational Behavior and Economic Theory*, 70 J. POL. ECON. 1, 1–2 (1962).

ars have made a formidable case that separation of ownership and control, fiat authority, and shareholder wealth maximization are majoritarian in nature, Professor Ann M. Lipton, among others, has recently argued, quite cogently, that the majority may be splintering.[222]

If selecting legal default rules by divining majority preference is going to be the framework for selecting and reforming corporate law rules, Professor Lipton's analysis perhaps foreshadows a shift toward the long-desired—in some quarters—stakeholderist model, or something else. If, on the other hand, legal default rules are selected by careful observation of the coordination points that have been successful in the past, then it becomes less clear that a stakeholderist model or some other reform is appropriate. Majoritarian preferences, hypothesized, stated, or revealed, are inevitably context-specific. So, too, are Schelling points. The shareholder wealth maximization Schelling point cannot, *a priori*, reflect that the majority prefers it or that it is optimal, but alternative models cannot, *a priori*, premise their proposed superiority without a clear understanding of how context-specific coordination around shareholder wealth maximization contributes to the value of investing in public corporations.

It does so by providing a point of agreement superior to not participating in the bargain by permitting both sides to make a credible commitment to one another. This is true even though managers and directors have fiat authority to run the corporation, even when shareholders remain rationally ignorant of most exercises of that authority. Shareholders will put up with managers and directors having practically unreviewable authority, as long as they appear to be using that authority toward the ultimate end of shareholder wealth. If they start expressly stating they intend to allocate all potential shareholder wealth to other constituencies, they will have, as Professor Bainbridge put it, slain the golden goose.[223] This illustrates what makes a Schelling point a Schelling point: it coordinates bargainers in a

[222] Lipton, *supra* note 21, at 865–66, 868–70.

[223] Bainbridge, *supra* note 21, at 1444. Arguably, this is why the Michigan Supreme Court rapped the hand belonging to Henry Ford. That is, he looked at all of the surplus Ford Motor Company had produced and decided it would be best deployed not just for the long-term interest of Ford Motor Company the business institution, but for the good of all mankind. Put in modern terms, that was not what the Dodge brothers—or Ford himself—had bargained for.

high-transaction-cost environment. Take away the Schelling point, and the bargaining process could very easily spin out of control.[224]

4. Stickiness—Once a Schelling Point, Always a Schelling Point

One of the interesting features of Schelling points is that once one is established (by law or agreement or otherwise), it tends to be even more "focal" than it was in the beginning.[225] As Professor David Friedman pointed out, Schelling's work suggested that parties would take seemingly inefficient actions—perhaps even to the point of seeming cognitively-biased—merely to preserve the past point of agreement.[226]

As conceded here, viewing shareholder wealth maximization as a Schelling point does not answer the question, "is shareholder wealth maximization the optimal rule?" In fact, this Article makes the distinct concession that shareholder wealth maximization may not be the optimal rule in all cases. Its potential for mischief has been robustly theorized, if not completely empirically shown. Other interests matter, moral questions abound, and aesthetic preferences have value, too.[227] A concession this Article wishes to elicit from those perhaps considering a normative shift away is that shareholder wealth maximization has an emergent quality and an empirical value that is not always captured in the contested arguments supporting its downstream economic efficiency or doctrinal sturdiness. That is, claims about inefficient outcomes, exception-laden doctrines, and alternative hypothetical bargains[228] do not, and perhaps *cannot*, fully address the coordinating power of the norm. The coordinating power of the norm came first, then the law enshrined it, and now

[224] John H. Cochrane, *Toward a Run-Free Financial System*, in ACROSS THE GREAT DIVIDE: NEW PERSPECTIVES ON THE FINANCIAL CRISIS 197, 206–08, 215 (Martin Neil Baily & John B. Taylor eds., 2014) (describing a theory of "information sensitivity" in financial assets).

[225] Friedman, *supra* note 13, at 8; *see also* Andrew S. Gold, *The New Concept of Loyalty in Corporate Law*, 43 U.C. DAVIS L. REV. 457, 518–19 (2009) (describing the role of judicial opinions in establishing focal points); *see generally* McAdams, *supra* note 125 (describing and evaluating the role of legal rules and institutions in generating focal points); *see generally* Ahdieh, *supra* note 127 (presenting the argument that government regulation may in some cases facilitate better coordination points than those which emerge on their own).

[226] Friedman, *supra* note 13, at 8–9.

[227] Paul Weitzel & Zachariah J. Rodgers, *Broad Shareholder Value and the Inevitable Role of Conscience*, 12 N.Y.U. J.L. & BUS. 35, 41–42 (2015); *see also* R.H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1, 43 (1960); Green, *supra* note 22, at 1412–13.

[228] *See supra* Section II.B.

investors' expectations for it are sticky. This suggests, at minimum, that shareholder wealth maximization is creating value, even if it is not creating or capturing all potential value.

V. CONCLUSION

Shareholder wealth maximization's justifications and critiques focus on its economic efficiency or lack thereof, its doctrinal sturdiness or lack thereof, and its potential ability to create social value or impede desired social reforms. This debate takes place downstream—that is, it takes place in a world where shareholder wealth maximization is at least mostly understood to be the governing norm and the animating principle of legal duties of managers and directors. Critics have robustly shown that the downstream benefits allegedly attributable to shareholder wealth maximization are more elusive than they should be, even if they are not illusory. This Article provides a different view of the question. It argues that the shareholder wealth maximization norm is an emergent, privately created coordinating point that arose from a high-transaction-cost bargain. That is, the shareholder wealth maximization norm is a Schelling point. Since the participants in the corporate bargain need each other to generate a surplus from economic activity, but cannot communicate with one another in a low-cost way, they need a way to solve this coordination problem. A Schelling point is an intuitive, imperfect way to solve a problem, so the bargainers may be expected to find each other there. The Schelling point in this bargain is a commitment from managers and directors to maximize the financial value of the firm, and therefore maximize the shareholders' wealth. Shareholder wealth maximization may not always be optimal, but it is reliably useful.