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Public Primacy in Corporate Law

*Dorothy S. Lund**

ABSTRACT

This Article explores the malleability of agency theory by showing that it could be used to justify a "public primacy" standard for corporate law that would direct fiduciaries to promote the value of the corporation for the benefit of the public. Employing agency theory to describe the relationship between corporate management and the broader public sheds light on aspects of firm behavior, as well as the nature of state contracting with corporations. It also provides a lodestar for a possible future evolution of corporate law and governance: minimize the agency costs created by the divergence of interests between management and the public.

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INTRODUCTION

Shareholder primacy is a widely accepted theory of governance that dictates that corporations be managed in the interests of shareholders.[1] It continues to shape corporate decisionmaking, as well as the path of corporate law and governance, despite vocal calls to revisit it.[2] The durability of shareholder primacy in academic circles can be attributed in part to the widespread acceptance of agency theory, and in particular, the determination that minimizing the divergence of incentives between management and shareholders is the chief goal for corporate governance.[3] According to "agency cost essentialists," corporate law and governance should minimize agency costs by empowering shareholders and making fiduciaries beholden to shareholder interests.[4] Importantly, this is not because shareholders are deserving of preferential treatment, but because maximizing shareholder value is thought to be the best means of maximizing corporate value and overall social welfare.[5]

A primary reason for this conclusion is the lack of a workable alternative. Indeed, agency theory highlights that agents are not perfect, but deeply flawed. As a result, agency cost essentialists contend that corporate fiduciaries will seek to maximize their private benefits if given discretion

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1. To facilitate that goal, some shareholder primacy advocates also contend that shareholders should have ultimate control over the corporation. Robert B. Thompson, *Anti-Primacy: Sharing Power in American Corporations*, 71 BUS. LAW. 381, 387–88 (2016); Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547 (2003).

2. *See, e.g.*, Lucian A. Bebchuk & Roberto Tallarita, *The Illusory Promise of Stakeholder Governance*, 106 CORNELL L. REV. (forthcoming 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3544978 [https://perma.cc/PL26-YDSC]; Dorothy Lund & Elizabeth Pollman, *The Corporate Governance Machine*, 121 COLUM. L. REV. 2563 (2021).

3. *See* David Millon, *Radical Shareholder Primacy*, 10 U. ST. THOMAS L.J. 1013, 1013 (2014); *see also* Zohar Goshen & Richard Squire, *Principal Costs: A New Theory for Corporate Law and Governance*, 117 COLUM. L. REV. 767 (2017).

4. *See* Goshen & Squire, *supra* note 3 (coining the term "agency cost essentialism"); *see also* Margaret Blair & Lynn Stout, *A Team Production Model of Corporate Law*, 85 VA. L. REV. 248, 263 (1999) (referring to the conventional model of the firm as the "grand-design principal-agent model").

5. *See generally* FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW (Harvard Univ. Press, 1996) [hereinafter ECONOMIC STRUCTURE].

or too broad a task.[6] By contrast, focusing fiduciary attention on the narrow and easy-to-monitor directive to maximize shareholder wealth should reduce agency costs and increase corporate value,[7] enabling the corporation to share its wealth with other constituents, including employees, creditors, and the broader community.[8] If the corporation's activity nonetheless results in negative externalities, regulation exists to pick up the slack.[9]

These arguments have proven to be quite sticky. Indeed, agency cost essentialism has not only permeated the academic literature, but also dramatically influenced the evolution of corporate law and corporate governance in two important ways.[10] First, fiduciary discretion has evolved to explicitly mandate a focus on shareholders, not only when the company is sold but also during the ordinary course of business; and second, governance reforms designed to empower shareholders and align management incentives with their interests have taken hold.[11] As a result of these reforms and the increased concentration of institutional investors, management alignment with shareholders is at an all-time high.[12]

This Article explores the theoretical support for shareholder primacy and in particular, its malleability. In so doing, it articulates a rival "public primacy" standard that would ask fiduciaries to promote the value of the corporation for the benefit of the public (which encompasses shareholders alongside other corporate constituencies). It shows that agency theory and the "nexus of contracts" theory of the firm can support such a standard.[13] More specifically, although scholars have explored agency relationships between management, shareholders, and creditors, this Article reveals that management can also be viewed as an agent of the public, with the state serving as the connective tissue.[14] Viewing the relationship between the

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6. *Id.*

7. *See, e.g.*, Bebchuk & Tallarita, *supra* note 2; Mariana Pargendler, *Controlling Shareholders in the Twenty-First Century: Complicating Corporate Governance Beyond Agency Costs*, 45 J. CORP. L. (2020) (manuscript at 17), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3474555 [https://perma.cc/S8S8-P8H6] (describing the law and economics analysis as premised on functional specialization in which "each field has one key efficiency objective").

8. EASTERBROOK & FISCHEL, ECONOMIC STRUCTURE, *supra* note 5.

9. *Id.*

10. *See* Lund & Pollman, *supra* note 2.

11. *See* Section I *infra*.

12. *See, e.g.*, Edward B. Rock, *Adapting to the New Shareholder-Centric Reality*, 161 U. PA. L. REV. 1907 (2013).

13. *See, e.g.*, Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976); John Armour, Henry Hansmann & Reinier Kraakman, *Agency Problems and Legal Strategies*, *in* THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH (Oxford Univ. Press, 3d ed. 2017).

14. By state, I mean the government actors that contract with the corporation. These include the state of incorporation as well as the federal and local government. Note that agency theory contemplates that an agent can have multiple principals. *See, e.g.*, Sean Gailmard, *Multiple Principals and Oversight of Bureaucratic Policy-Making*, 21 J. THEORETICAL POL. 161 (2009).

public and management as one of agency explains certain aspects of firm behavior, including the existence of industry self-regulation—under the agency framework, management incurs these bonding costs to signal alignment with the public.[15] It also sheds light on aspects of state "contracting"[16] with the corporation. Just as shareholders demand pay-for-performance compensation to align incentives between management and shareholders, the state sometimes employs incentive alignment devices to control agency costs. These include tax breaks and subsidies for public-interested corporate conduct, such as keeping jobs in the state or producing a COVID-19 vaccine at scale.[17]

And finally, the presence of state agency costs—the fact that the state cannot be counted on to serve the public interest in every case—explains how the contractual relationship between the state and corporation has evolved. In particular, early governance mechanisms that ensured strict state control over corporate activity have since been relaxed, as evidence mounted that they did not serve the public interest because of the state's imperfections as an agent of the public.[18] These imperfections persist to this day; therefore, my analysis does not call on corporate governance to promote any obligation to the state, or indicate that the state should have additional control and influence over corporate governance. It simply shows that just as we can trace an agency relationship between shareholders and management, we can do the same between shareholders and the public, with the state serving as the connective tissue.

There are, however, reasons to believe that promoting an obligation to the public (which again includes shareholders as well as other constituencies) could be viewed as a core focus for corporate law and governance. At the outset, this orientation is consistent with early corporate law, which required corporations to demonstrate a public benefit as a condition of receiving a charter. This condition was only relaxed when it became clear that the requirement did not serve the purpose of advancing public welfare, and when other areas of law—and antitrust and securities regulation in particular—expanded to more adequately constrain corporate activity that harmed the public.[19]

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15. *See* notes 76–83 *infra* and accompanying text.

16. I use the term "contract" as it is employed in institutional economics contract theory, rather than the legal sense of the term.

17. *See* notes 77–75 *infra* and accompanying text. Of course, the contractual relationship between a corporation and the state is hardly an arm-length one. Nonetheless, the state does at times contract with corporations on a voluntary basis, as in when the state offers a subsidy for business practices that confer a public benefit.

18. *See* Section II.B.a *infra*.

19. *Id.*

In addition to this historical fit, law and economics theory also supports a public primacy standard. For example, classic law and economics theory supporting shareholder primacy does so on the grounds that shareholders are the residual claimants—those who bear residual risk from the company's operations and have a claim on the company's residual profits.[20] But the public also bears residual risk, and more so than shareholders, whose losses are cabined by limited liability. Not only that, the public also has a substantial residual interest in the firm's profits—it benefits from increased employment and tax revenue when companies are profitable.[21]

Public primacy could also deliver on the welfarist goals of corporate governance, assuming that governance mechanisms evolved to promote fidelity to a broader goal. In particular, a public primacy directive could provide a means of internalizing the impact of corporate choices on all of the corporation's stakeholders and the broader public, which has become more necessary due to the erosion of externality regulation.[22] Consider the following example: a management team is considering whether to continue requiring victims of sexual harassment to enter into NDAs. Under the shareholder primacy framework, they will be pushed to evaluate whether the policy maximizes shareholder returns. Any discussion of whether NDAs harm future victims would only be relevant to the extent that harm also affects shareholders. Under public primacy, however, management would be asked to promote the value of the corporation for the benefit of the public. As such, shareholder returns would not be ignored, but they would be balanced with other objectives: minimizing victim harm, improving corporate culture, improving employee productivity, and so on. Put simply, all of these concerns would become directly relevant under public primacy, rather than a mere means of improving shareholder welfare.

This example showcases the promise of a public primacy standard, but also raises weaknesses, and in particular, that the broadened discretion that public primacy entails could lead to an increase in agency costs that would harm not only shareholders but the broader public. But public primacy also provides a lodestar for the future evolution of corporate governance in service of minimizing agency costs that are created by the divergence of interests between management and the public. In particular, corporate planners could employ governance devices to facilitate outside

20. *See* notes 40–42, 99–103 *infra* and accompanying text.

21. *See* Section II.B *infra*.

22. The classic view is that corporate governance is not well-suited to address social problems, and that the latter concern should be left to regulation. I address the inadequacy of this view in Section III.C.c. *infra*.

monitoring and create tailored incentives to help the company achieve its public-oriented goals.

How could such an evolution away from shareholder primacy and toward public primacy manifest? The lesson from the rise of shareholder primacy is that discourse matters, and that theoretical arguments can powerfully affect norms in corporate governance as well as the path of legal and extra-legal reform.[23] The goal of this Article is to show that the theoretical arguments supporting shareholder primacy also support a standard with a different normative prescription. In so doing, the Article provides a theoretical foundation for governance movements that seek to allow fiduciaries leeway to promote the interests of the company's stakeholders and the broader public, in addition to shareholder welfare.[24]

This Article proceeds as follows. Part II charts the rise of shareholder primacy and the influence of agency theory on corporate law and governance. Part III shows how agency theory can be used to advance a public-facing orientation for corporations. It then considers the theoretical and historical support for giving the public primacy in corporate law and governance. Part IV considers what an embrace of public primacy might entail, addressing limitations and presenting a framework for the evolution of corporate governance in a public primacy direction.

I. SHAREHOLDER PRIMACY AND AGENCY COST ESSENTIALISM

This Part describes how agency theory has influenced corporate law and corporate governance. It explains how a descriptive theory with few normative prescriptions evolved into shareholder primacy, which urges corporations to prioritize shareholder interests above all else. It then highlights how the widespread acceptance of shareholder primacy has transformed corporate law and governance.

A. From Agency Theory to Shareholder Primacy

In 1976, Michael Jensen and William Meckling meshed agency theory and corporate law in an influential article, making explicit an analysis

23. *See* Ed Rock, *Saints And Sinners: How Does Delaware Corporate Law Work*?, 44 UCLA L. REV. 1009 (discussing how Delaware fiduciary law is generated and articulated through a narrative process).

24. Two prominent examples are the stakeholder governance and benefit corporation movements, which have thus far proceeded without an underlying theory to support them. *See generally* John Amis, Jay Barney, Joseph T. Mahoney & Heli Wang, *From the Editors—Why We Need a Theory of Stakeholder Governance—And Why This Is a Hard Problem*, 45 ACAD. MANAGEMENT REV. (2020). My theory also provides an intellectual framework for refining and critiquing these movements. *See infra* note 226.

that legal scholars and economists had touched on for years.[25] According to agency theory, an agency relationship is one in which a principal engages an agent to perform some service on their behalf, which involves delegating decisionmaking authority to the agent.[26] The key insight is that the interests between the principal and agent often diverge; as such, the principal may need to expend resources monitoring the agent's activities and devising ex ante incentive alignment devices.[27] In addition, the agent might incur bonding costs to establish that they will not act counter to the principal's interests.[28] Together, these costs (combined with the residual loss, defined as the reduction in principal welfare that comes from the divergence of incentives) represent agency costs.[29]

As this model suggests, the agency theory framework fits many relationships: employers and employees, elected officials and citizens, and as Jensen and Meckling pointed out, shareholders and management.[30] As for the latter group, Jensen and Meckling observed that shareholders who provide equity capital to the company but are not involved in management need to design structures to constrain managerial opportunism, and in particular, management's tendency to appropriate perquisites and other benefits that lower firm value.[31] As such, "economic natural selection" would favor mechanisms that minimize agency costs within corporations—executive compensation tied to stock price, or a board of directors that monitors management, to take two examples.[32] In other words, agency theory sought to understand how corporations had evolved and survived, but offered few normative prescriptions.

Although Jensen and Meckling primarily focused on the agency relationship between shareholders and management, they did not suggest

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25. *See generally* Jensen & Meckling, *supra* note 13. Milton Friedman had earlier implicated agency theory in his 1970 New York Times Op-Ed, which announced that corporate management were "agent[s] of the individuals who own the corporation . . . and [their] primary responsibility is to them." Milton Friedman, *The Social Responsibility of Business Is to Increase Its Profits*, N.Y. TIMES MAG., Sept. 13, 1970, at 17. This analysis had roots in classic corporate law thinking, including Adolf Berle's position that corporate fiduciaries should manage the corporation for the benefit of shareholders. *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049, 1060–69 (1931). Although Berle did not rely on agency theory explicitly, his concern that managerial self-dealing would compromise a mandate to consider the public interest is a precursor to the agency analysis.

26. *See* Jensen & Meckling, *supra* note 13.

27. *Id.*

28. *Id.*

29. *Id.*

30. *See, e.g.*, Armour, Hansmann & Kraakman, *supra* note 13.

31. *See* Jensen & Meckling, *supra* note 13.

32. *Id.*; *see also* Eugene F. Fama & Michael C. Jensen, *Separation of Ownership and Control*, 26 J.L. & ECON. 301 (1983) (asking why public companies that separate ownership and control survive and suggesting that organizational contracts allocate decision rights in beneficial ways); Eugene F. Fama, *Agency Problems and the Theory of the Firm*, 88 J. POL. ECON. 288 (1980).

that this was the only relevant agency relationship; by contrast, they believed that the understanding that corporations were mere bundles of contracting relationships would "lead to a rich theory of organizations which is now lacking in economics and the social sciences generally."[33] And from that time on, scholars did consider how corporate law and corporate governance work to constrain agency costs across various dimensions—between bondholders and shareholders, controlling shareholders and minority shareholders, and the firm and other constituents such as creditors, employees, and customers.[34] However, shortly after the publication of Jensen and Meckling's piece, law and economics scholars mixed agency theory and agency law concepts, which set the foundation for the shareholder primacy thinking that dominates corporate law today.

Credit for this move belongs to Daniel Fischel, who was the first to rely on agency theory in a law review article. In his 1978 article, Fischel argued that shareholders were in a *legal* agency relationship with management, and as a result, shareholder interests should be paramount in managerial decisionmaking.[35] Note that this logic does not follow from Jensen and Meckling's article, which had a looser characterization of what agency relationships entailed.[36] Essentially, Fischel had blended agency theory and agency law, and applied it to corporate law. And this analysis suggested that management had a fiduciary duty to shareholders above all other groups.[37]

And yet, as many scholars have pointed out, the shareholder-management relationship does not qualify as a legal agency relationship, or qualifies as a weak form at best. In particular, a hallmark of a legal agency relationship is that the principal has the right to control the agent's behavior.[38] But the legal rights awarded shareholders—specifically, the right to

33. Jensen & Meckling, *supra* note 13, at 309.

34. Armour, Hansmann & Kraakman, *supra* note 13; Rock, *supra* note 12; Charles W. L. Hill & Thomas M. Jones, *Stakeholder-Agency Theory*, 29 J. MGMT. STUD. 131 (1992). Scholars have also explored the costs that come from principal control. *See* Goshen & Squire, *supra* note 3.

35. In this particular context, Fischel's argument was that shareholder interests should guide any evaluation of the hostile takeover market. Daniel R. Fischel, *Efficient Capital Market Theory, the Market for Corporate Control, and the Regulation of Cash Tender Offers*, 57 TEX. L. REV. 1 (1978).

36. *See* Scott Tong, *How Shareholders Jumped to First in Line for Profits*, MARKETPLACE (June 14, 2016), https://www.marketplace.org/2016/06/14/profit-shareholder-value/ [https://perma.cc/ZQ9G-J96B] (quoting Michael Jensen who stated, "I wouldn't put shareholders at the center. I'm still unhappy about the situation where people end up thinking that shareholders are primary. That they are our only bosses. No.").

37. *See also* Frank H. Easterbrook & Daniel R. Fischel, *Contract and Fiduciary Duty*, 36 J.L. & ECON. 425 (1993) (applying agency law and theory to clarify the fiduciary duty between equity investors and management).

38. *See* RESTATEMENT (THIRD) OF AGENCY § 1.01, cmt. A, cmt. B (AM. L. INST. 2006) ("The person represented has a right to control the actions of the agent."); *see also* LYNN A. STOUT, THE

vote on director elections, veto certain transitions, and sue for breach of fiduciary duty—provide little control over director behavior, indicating that management would not qualify as agents of shareholders in a legal sense.[39]

Nonetheless, this application of agency theory rapidly spread among corporate law scholars, who designated minimizing agency between shareholders and management as the core problem for corporate law and corporate governance.[40] Fischel, joined by Frank Easterbrook, continued to apply the framework in a series of articles[41] and eventually, in their influential book, the ECONOMIC STRUCTURE OF CORPORATE LAW. That book characterized management as an agent of the "residual claimant" shareholders, with an obligation to maximize shareholder wealth.[42] This theory is the well-known shareholder primacy theory for corporate law, and it has agency theory at its core.

But Easterbrook and Fischel not only offered a positive defense of shareholder primacy, but also a normative one: in their view, prioritizing shareholder interests would promote overall welfare. For one, they contended that the directive to maximize shareholder value would maximize the wealth of the corporation because investors would pay more for the stock of a company that did so. The alternative—asking fiduciaries to serve the public, as well as shareholders—would lead to an erosion in

SHAREHOLDER VALUE MYTH: HOW PUTTING SHAREHOLDERS FIRST HARMS INVESTORS, CORPORATIONS, AND THE PUBLIC (2012) [hereinafter SHAREHOLDER VALUE MYTH]; Steven Bainbridge, *Director Primacy* (UCLA Sch. of L., Working Paper No. 10-06, 2010).

39. *See* STOUT, SHAREHOLDER VALUE MYTH, *supra* note 38.

40. *See, e.g.*, Frank H. Easterbook & Daniel R. Fischel, *Corporate Control Transactions*, 91 YALE L.J. 698, 700 (1981) ("Fiduciary principles govern agency relationships."); William W. Bratton, *The "Nexus of Contracts" Corporation: A Critical Appraisal*, 74 CORNELL L. REV. 407, 408 (1989) ("Law and economics writers recast corporate law in its terms and succeeded in reorienting the corporate law discourse . . . ."). For relatively modern examples, *see* Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 439–40 (2001) (arguing that "ultimate control over the corporation should rest with the shareholder[s]"); Jonathan R. Macey, *An Economic Analysis of the Various Rationales for Making Shareholders the Exclusive Beneficiaries of Corporate Fiduciary Duties*, 11 STETSON L. REV. 23, 23 (1991) ("Directors and officers are legally required to manage a corporation for the exclusive benefit of its shareholders, and protection for other sorts of claimants exists only to the extent provided by contract.").

41. Frank H. Easterbrook & Daniel R. Fischel, *Close Corporations and Agency Costs*, 38 STAN. L. REV. 271 (1986); Easterbrook & Fischel, *Corporate Control Transactions*, *supra* note 40; Frank H. Easterbrook & Daniel R. Fischel, *Limited Liability and the Corporation*, 52 U. CHI. L. REV. 89 (1985); Frank H. Easterbrook & Daniel R. Fischel, *Voting in Corporate Law*, 26 J.L. & ECON. 395 (1983); Daniel R. Fischel, *The Corporate Governance Movement*, 35 VAND. L. REV. 1259 (1982).

42. EASTERBROOK & FISCHEL, ECONOMIC STRUCTURE, *supra* note 5, at 37.

accountability that would reduce corporate value.[43] Not only that, a regime that maximized corporate wealth would assist other constituencies as well:

> A successful firm provides jobs for workers and goods and services for consumers. . . . Other objectives, too, come with profit. Wealthy firms provide better working conditions and clean up their outfalls; high profits produce social wealth that strengthens the demand for cleanliness. Environmental concerns are luxury goods; wealthy societies purchase much cleaner and healthier environments than do poorer nations—in part because well-to-do citizens want cleaner air and water, and in part because they can afford to pay for it.[44]

Put simply, according to Easterbrook and Fischel, giving shareholders precedence would benefit not only the corporation, but all those that interact with it. When corporate behavior nonetheless created negative externalities, regulation should pick up the slack.[45] I will return to these normative foundations in the next Part; for now, the main takeaway is that shareholder primacy was not viewed as an end in itself, but the best means of maximizing societal welfare.

B. Agency Theory's Influence Over Corporate Law and Governance

The agency cost framework was enormously influential.[46] Today, most corporate law scholars rely on agency theory in discussing the purpose of the corporation, as well as the scope of fiduciary discretion.[47] Agency theory has also permeated the language used by corporate management and corporate regulators and has contributed to a reorientation in

43. *Id.* at 38 ("[A] manager told to serve two masters . . . has been freed of both and is answerable to neither . . . . Agency costs rise and social wealth falls."). Easterbrook and Fischel also argued that giving the residual claimant shareholders control rights, like the ability to vote on director elections, would maximize corporate value because those shareholders would seek to maximize the value of the residual claim—or everything that is left after contracting parties with fixed claims have been paid. I discuss this argument in Section III.B *supra*.

44. *Id.*

45. "When costs fall on third parties—pollution is the common example—firms do injury because harm does not come back to them as a private cost. . . . No rearrangement of governance structures can change this." *Id.* at 39.

46. *See, e.g.*, Millon, *supra* note 3, at 1033 ("Describing the corporation as a nexus of contracts and viewing management as agent of the shareholders obligated to maximize shareholder wealth, the Easterbrook and Fischel vision of the corporation and corporate law has largely defined the agenda for mainstream, economically-oriented corporate law scholarship."); Bratton, *Nexus of Contracts*, *supra* note 40.

47. *See, e.g.*, Ian Ayres & Peter Cramton, *Relational Investing and Agency Theory*, 15 CARDOZO L. REV. 1033, 1036 (1994) (noting that today, "a widely accepted goal of corporate governance is to economize on agency costs"); John H. Matheson, *Corporate Governance at the Millennium: The Decline of the Poison Pill Antitakeover Defense*, 22 HAMLINE L. REV 703, 709 (1999) ("The great challenge of corporate law in the modem era, then, is to minimize agency costs by constraining abuse of managerial discretion."); Millon, *supra* note 3; Bratton, *Nexus of Contracts*, *supra* note 40.

corporate law and governance toward shareholder primacy.[48] Many have described these changes, and I will not belabor them, but will instead highlight four major trends: First, agency theory contributed to the reorientation of the board of directors toward a monitoring model.[49] Initially the board was thought to function as a representative assembly of constituents, but by the 1980s, the consensus view was that the board ought to monitor management to protect shareholder interests.[50] Second, agency theory has provided a basis for reforms that strengthened shareholder voting and intervention rights.[51] Third and relatedly, agency theory led to reforms that limited management's capacity to defend against hostile takeovers and proxy fights.[52] And fourth, agency theory contributed to the embrace of equity-based executive pay.[53] As a result of these changes, as Edward Rock put it, "there is substantial reason to believe that managers and directors today largely think like shareholders."[54] And thinking like shareholders means that management regularly puts shareholder interests first.

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48. Brian Misamore, *Can I Trust You? How Google and Apple Approach the Principal-Agent Problem*, HARV. BUS. SCH. ONLINE BUS. INSIGHTS BLOG (June 21, 2018), https://online.hbs.edu/blog/post/apple-google-principle-agent-problem [https://perma.cc/R8T4-2MJZ]; RAKESH KHURANA, FROM HIGHER AIMS TO HIRED HANDS: THE SOCIAL TRANSFORMATION OF AMERICAN BUSINESS SCHOOLS AND THE UNFULFILLED PROMISE OF MANAGEMENT AS A PROFESSION 365 (Princeton Univ. Press, 2010) ("Inside business schools, economists on finance faculties used principal-agent theory to recast the role of management. . . . Meanwhile, business school professors instructed thousands of students and executives on how to use financial engineering tools, like leverage and stock options, to align corporate actions with the goal of maximizing shareholder value."); Jay Clayton, Chairman, SEC, Opening Remarks to SEC-NYU Dialogue on Securities Markets #4: Shareholder Engagement (Jan. 19, 2018), https://www.sec.gov/news/speech/clayton-2018-01-19 [https://perma.cc/SEG4-84SY]; *see* COMM. ON CAP. MKTS. REG., INTERIM REPORT 93 (2006), https://capmktsreg.org/wp-content/uploads/2022/11/Interim-Report-of-the-Committee-on-Capital-Markets-Regulation-1.pdf [https://perma.cc/665L-T2DB].

49. *See, e.g.*, Fama & Jensen, *supra* note 32, at 311.

50. Jeffrey N. Gordon, *The Rise of Independent Directors in the United States, 1950–2005: Of Shareholder Value and Stock Market Prices*, 59 STAN. L. REV. 1465, 1506 (2007) (noting that the "predominant model of board behavior has moved towards the monitoring board and away from the advisory board" and that this has contributed to the rise of independent directors); Matheson, *supra* note 47; Lund & Pollman, *supra* note 2.

51. *See, e.g.,* Lucian Arye Bebchuk, *The Case for Increasing Shareholder Empowerment*, 118 HARV. L. REV. 833 (2005); Goshen & Squire, *supra* note 3.

52. *See* Matheson, *supra* note 47; *see also* Gail Weinstein, Philip Richter & Warren S. de Wied, Fried Frank, *A Turn Back to "Poison Pills" in Response to the Coronavirus Pandemic*, HARV. L. SCH. F. ON CORP. GOVERNANCE (April 9, 2020), https://corpgov.law.harvard.edu/2020/04/09/a-turn-back-to-poison-pills-in-response-to-the-coronavirus-pandemic/ [https://perma.cc/VQ9K-9C5H] ("Rights plans, which once were ubiquitous among larger companies, fell out of favor with institutional investors and the leading proxy advisory firms in the early 2000's and have not been widely utilized since then . . .").

53. *See* Michael Jensen & Kevin Murphy, *Performance Pay and Top-Management Incentives*, 98 J. POL. ECON. 225, 261–62 (1990).

54. Rock, *supra* note 12, at 1910.

In addition to influencing corporate governance practice, agency theory has influenced judicial decisions—in Delaware in particular. Before the 1980s, Delaware courts had not squarely addressed the issue of whether a corporation's purpose requires fidelity to shareholder interests. After agency theory became ascendant, however, judicial decisions moved in a shareholder primacy direction. The beginning of this evolution took place during the hostile takeover wave, when the Delaware Supreme Court considered in *Unocal v. Mesa Petroleum* whether a board facing a takeover bid could consider the interests of constituencies other than shareholders.[55] In applying heightened scrutiny to the director's decision, the court emphasized the "omnipresent specter that a board may be acting primarily in its own interests, rather than those of the corporation and its shareholders"—thereby directly acknowledging the core agency problem at issue.[56] Ultimately, however, the court concluded that a board could consider corporate constituencies in addition to shareholders when evaluating a takeover bid, specifically rejecting Easterbrook and Fischel's view that the only appropriate course of action for management, as agents of shareholders, is complete passivity in the face of a tender offer.[57]

But agency cost essentialists did not have to wait long for a correction—a year later, the Delaware Supreme Court reversed this earlier ruling in *Revlon v. MacAndrews & Forbes Holdings*, holding that "while concern for various corporate constituencies is proper when addressing a takeover threat, that principle is limited by the requirement that there be some rationally related benefit accruing to the stockholders."[58] Several decades later, the Delaware Court of Chancery offered even stronger support for a shareholder primacy view, stating in *eBay Domestic Holdings v. Newmark* that directors are duty bound to promote the value of the corporation and its stockholders.[59] The decision did not explicitly reference agency theory, but the decision to view fiduciaries as obligated to promote shareholder interests was a direct outgrowth of Easterbrook and Fischel's analysis, which had become sufficiently ubiquitous that the shareholderist

55. Unocal v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985).

56. *Id.* at 954.

57. *Id.* at 955.

58. Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 179 (Del. 1986).

59. eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 35 (Del. Ch. 2010) ("Directors of a for-profit Delaware corporation cannot deploy a rights plan to defend a business strategy that openly eschews stockholder wealth maximization—at least not consistently with the directors' fiduciary duties under Delaware law."). Note that the operation of the business judgment rule renders this obligation largely toothless except for in extreme cases, where the fiduciary "confesses" that they are treating stakeholder welfare as end, rather than a means of maximizing shareholder welfare. *See* Leo E. Strine, Jr., *The Dangers of Denial: The Need for a Clear-Eyes Understanding of the Power and Accountability Structure Established by the Delaware General Corporation Law*, 50 WAKE FOREST L. REV. 761 (2015).

orientation was taken as given. Other Chancery Court decisions have made the connection to agency theory explicit.[60]

II. Public Primacy

This Part shows how agency theory can be used to advance a public-facing orientation for corporations. It describes how this paradigm sheds light on aspects of firm behavior and state contracting with the corporation. It then considers the historical and theoretical support for giving the public primacy in corporate law and governance.

A. The Public as Principal

Scholars who have previously imputed a public-facing nature to the corporation have put themselves in opposition to the nexus of contracts theory of the firm that is at the foundation of agency theory.[61] However, these concepts can be reconciled. Specifically, the public contracts with the corporation (again, in the institutional economics sense), using the state as its agent,[62] in order to limit the divergence of interests between the public and the corporation. And this activity indicates that an agency relationship exists between the public (the principal) and corporate management (the agents).

The state promotes fidelity to the public interest in a few different ways. First, to form a corporation, a charter must be filed with the state, and that governing document includes a public-facing commitment to abide by the law.[63] Under this contract, the state retains the power to revoke or void the company's charter if the corporation breaks certain laws.[64] Second, to operate a business, the corporation must obtain business

60. *See in re* Trados Inc. S'holder Litig., 73 A.3d 17, 37 (Del. Ch. 2013) ("In terms of the standard of conduct, the duty of loyalty therefore mandates that directors maximize the value of the corporation over the long-term for the benefit of the providers of equity capital, as warranted for an entity with perpetual life in which the residual claimants have locked in their investment."); Bird v. Lida, Inc., 681 A.2d 399, 402–03 (Del. Ch. 1996) (citing Jensen & Meckling, *supra* note 13); Blasius v. Atlas, 564 A.2d 651, 659–60 (1998) ("[A] decision by the board to act for the primary purpose of preventing the effectiveness of a shareholder vote inevitably involves the question who, as between the principal and the agent, has authority with respect to a matter of internal corporate governance.").

61. One exception is Hill & Jones, *supra* note 34, which traces agency relationships between firms and their stakeholders.

62. *Cf.* David A. Hoffman & Cathy Hwang, *The Social Cost of Contract*, 121 COLUM. L. REV. 979 (2021) (arguing that the public should be viewed as a third party to every contract).

63. *See, e.g.*, DEL. CODE ANN. Tit. 8, ch. 1; *see also* Elizabeth Pollman, *Corporate Disobedience*, 68 DUKE L. J. 709, 719–20 (2019) (observing that the DGCL's restriction to chartering companies with "lawful purposes" reflects public policy concerns); Leo E. Strine, Jr., *Remembering What Comes First Is More Important Than Ever*, FIN. TIMES (Mar. 27, 2020), https://www.ft.com/content/9ee6d82e-6fc2-11ea-89df-41bea055720b.

64. *See, e.g.*, DEL. CODE ANN. Tit. 8, § 510 (voiding a corporate charter for failure to pay tax); DEL. CODE ANN. Tit. 8, § 322 (the failure to obey a state decree or order is grounds for receivership).

licenses in the state and/or county where the business operates.[65] Depending on the nature of the business, multiple permits may be required; moreover, these permits can be revoked by the state, depriving the corporation of the ability to do business in the jurisdiction.[66] Third, the permits enable the state to control aspects of the business, collect taxes and other fees, and also collect information that helps the state monitor and ensure compliance with the law.[67]

In sum, there are two agency relationships layered between the public and corporate management. Diffuse public citizens elect government officials to act in their interest, and a rich literature in public law discusses that agency relationship (for the moment, let us naively assume that the state always acts in the interest of the public when discharges its duties).[68] Those state actors then induce corporations to act in the public's behalf in two ways: first, they adopt regulations that bind corporate actors,[69] and second, they contract with the company to control corporate operations and secure the information necessary to monitor corporate activity.[70] Of course, these contracts do not explicitly indicate that management has an obligation to act on behalf of the public. Likewise, when a shareholder purchases equity in a company, there is no communicated statement of intent to benefit the shareholder. Indeed, agency theory operates in a looser way: it identifies agency relationships on the basis of "contractual" relationships in organizational settings, in an attempt to locate agency costs and how they are managed.

Therefore, under this model, controlling the divergence of interests between management and the public is a key objective of state contracting.[71] Consider the following example: A management team is concerned

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65. *See, e.g.*, Diana Fitzpatrick, *How to Get a Small Business License in California*, NOLO, https://www.nolo.com/legal-encyclopedia/how-get-small-business-license-california.html [https://perma.cc/E6FW-Z8AU].

66. *See, e.g.*, *Permits and Licenses*, CAL. DEP'T OF TAX & FEE ADMIN., https://www.cdtfa.ca.gov/services/permits-licenses.htm [https://perma.cc/5JXX-YVD6] (last visited July 12, 2020).

67. *New Business Registration Requirements*, CITY OF L.A. OFF. OF FIN., https://latax.lacity.org/businessregapp/eappreg_criteria [https://perma.cc/H5TS-SZXB] (last visited July 12, 2020).

68. *See generally* D. Theodore Rave, *Politicians as Fiduciaries*, 126 HARV. L. REV. 617 (2013); Richard J. Pierce, Jr., *The Role of the Judiciary in Implementing an Agency Theory of Government*, 64 N.Y.U. L. REV. 1239 (1989).

69. Part III considers how an erosion of regulatory control supports the imposition of public-facing requirements via governance.

70. Again, I use "contract" as it is employed in institutional economics contract theory, rather than the legal sense of the term.

71. To the extent that managerial self-dealing harms shareholders and the corporation, it is also detrimental to the public interest. *See* Mark E. Van Der Weide, *Against Fiduciary Duties to Corporate Stakeholders*, 21 DEL. J. CORP. L. 27, 62 (1996) ("Therefore, maximizing the present value of the

that they will be fired if they cannot satisfactorily dispose of toxic waste. Because proper disposal would be very expensive and lower the company's stock price, management ultimately violates environmental protection laws by dumping it into a nearby river. [72] In this example, the illegal behavior benefits management but harms the public. Note that shareholder control doesn't necessarily solve the problem because shareholders also benefit from the illegal behavior. How to constrain the wayward agent? Ex ante, the company's state-granted charter requires an affirmative obligation to not break the law. In addition, the state requires regular disclosure about corporate operations, as well as inspection rights, to ensure that management does not violate this obligation. These arrangements supplement the state's ex post enforcement capabilities—the ability to fine or charge the corporation if it is caught polluting.

In addition, states can induce public interested corporate behavior in exchange for subsidies, tax breaks, and other rewards. Note that these incentive alignment devices function like executive compensation arrangements that incentivize corporate actors to think like shareholders: they similarly induce corporate actors to make the public welfare part of the calculus. As an example, consider a company that is choosing whether to move a factory overseas—a legal action that would allow management to cut costs and meet its quarterly revenue projections, but one that would have negative repercussions for the state and its citizens. In this situation, the state might contract with the company to align incentives, for example, by awarding a tax break for keeping the factory in state.[73] Indeed, this is exactly what happened when Indiana gave Carrier a $7 million tax break

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corporation's earnings stream maximizes the total value of the corporation and, thus, maximizes the corporation's contribution to social wealth."). For this reason, the state has an interest in controlling this agency problem as well, as part of its obligation to the public. One of the ways it does this is by adopting rules ex ante that prohibit self-dealing. It also designates enforcement rights to creditors and shareholders, and sometimes participates in enforcement in its capacity as a shareholder. *See* Press Release, N.Y. Off. of the Att'y Gen., A.G. Underwood Files Lawsuit Against Exxon Mobil for Defrauding Investors Regarding Financial Risk the Company Faces from Climate Change Regulations (Oct. 24, 2018) [hereinafter N.Y. Exxon Pension Litigation], https://ag.ny.gov/press-release/2018/ag-underwood-files-lawsuit-against-exxonmobil-defrauding-investors-regarding [https://perma.cc/F65V-SSNC].

72. Often, illegal corporate behavior is the product of self-interested managerial behavior: consider the Volkswagen emissions scandal, Enron scandal, and the BP Deepwater Horizon spill.

73. Note that the public can also exert extra-contractual pressure to constrain behavior that is legal and yet detrimental from a public welfare perspective. For example, consumer pressure and boycotts may induce companies to stop testing products on animals, raise employee wages, stop selling guns, and more. *See* Clare Carlile, *History of Successful Boycotts*, ETHICAL CONSUMER (May 5, 2019), https://www.ethicalconsumer.org/ethicalcampaigns/boycotts/history-successful-boycotts [https://perma.cc/FRR5-B4Z7]; Hillary A. Sale, The Corporate Purpose of Social License 32–36 (Feb. 19, 2020) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3403706 [https://perma.cc/LN5Y-VRY8] [hereinafter Social License].

to keep a thousand jobs in state in 2016.[74] For an example that involves the federal government, consider how in 2020, the U.S. Department of Health contracted with multiple pharmaceutical companies to provide funding that would support the rapid production of COVID-19 vaccines.[75]

The previous analysis has assumed, for the most part, that the state is a perfect agent for the public. Of course, we know better than that. The state (or the individuals who work for the state) may act to promote its own interest, rather the public interest. Indeed, the state can be conflicted, captured, or undermined by political ossification or interest group dynamics.[76] This leads to two results. For one, the state imperfectly regulates corporate externalities.[77] For example, a strict pollution limit might be in the best interest of the public, and yet the state could choose not to enact it because state legislators are captured by the regulated industry, or they hope to attract corporations that will generate revenue. This reality bears on my analysis in several respects. In particular, the absence of optimal externality regulation weakens the traditional justification of corporate governance's exclusion of third-party interests on the grounds that they are dealt with elsewhere. This is especially true in light of the fact that shareholder primacy contributes to the erosion of externality regulation and amplifies third-party harm.[78] Section III.C addresses these concerns further, but for now, the point is simply that the state's imperfections as a regulator of externalities may require corporate governance to play a larger role.[79]

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74. David Shepardson, *Indiana Agrees $7 Million Tax Break to Keep Carrier Jobs in State: Company*, REUTERS (Dec. 1, 2016), https://www.reuters.com/article/us-usa-trump-utc/indiana-agrees-7-million-tax-break-to-keep-carrier-jobs-in-state-company-idUSKBN13Q55W. State agency costs as well as state competition can lead to questions about whether such activity is necessarily in the public interest. As such, the public could bypass the state and instead use financing arrangements to induce prosocial corporate behavior. *See* Dorothy Lund, *Corporate Finance for Social Good* (USC Gould Sch. of L., Working Paper No. 20-3, 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3511631 [https://perma.cc/J4UX-EXX8].

75. *See* Press Release, U.S. Dep't of Health & Hum. Servs., U.S. Government Engages Pfizer to Produce Millions of Doses of COVID-19 Vaccine (July 22, 2020), https://www.defense.gov/News/Releases/Release/Article/2310994/us-government-engages-pfizer-to-produce-millions-of-doses-of-covid-19-vaccine/ [https://perma.cc/9CDB-EQE5].

76. Externality regulation, both at the state and federal level, is subject to interest group dynamics. *See* Henry N. Butler & Jonathan R. Macey, *Externalities and the Matching Principle: The Case for Reallocating Environmental Regulatory Authority*, 14 YALE L. & POL'Y REV. 23 (1996). Indeed, corporations are very willing to spend millions of dollars—either on lobbyists, or on direct candidate contributions—to thwart costly legislation. *See* Tim Wu, *The Goals of the Corporation and the Limits of the Law*, COLUM. L. SCH. BLUE SKY BLOG (Sept. 3, 2019), http://clsbluesky.law.columbia.edu/2019/09/03/the-goals-of-the-corporation-and-the-limits-of-the-law/ [https://perma.cc/VJ6E-HVG3].

77. *Id.*

78. *See* Elizabeth Pollman, *Constitutionalizing Corporate Law*, 69 VAND. L. REV. 640 (2016).

79. *See* Dorothy Lund, Toward a Dynamic View of Corporate Purpose (Working Paper). https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4665040.

Second, the state may imperfectly enforce the public interest by using its authority to advance the state's own interest (and more likely, the interest of those individuals with authority to act for the state). A vivid example of this reality will be discussed in Part III, and to preview, the lesson is that state influence and control over corporate governance is undesirable due to the state's imperfections as an agent.[80]

The agency paradigm not only sheds light on state contracting with corporations, it also helps explain aspects of firm behavior. For one, an increasingly common practice is for corporations to supplement their mandatory disclosure with voluntary disclosure about the company's environmental, social, and governance practices.[81] At first glance, it is surprising that corporations would open themselves up to scrutiny and potential legal liability by providing this additional disclosure; however, agency theory reveals that there is value in management bonding that reduces the principal's enforcement costs in the event of any substantial divergence in interests. Even more dramatically, corporations sometimes self-regulate. For example, many industries have adopted self-regulatory systems to limit environmental harm.[82] What induces private firms to adopt a voluntary apparatus that limits the scope of profitable behavior to minimize public harm? The answer: this action represents bonding costs that assure the public that the company will act in its interest. And these bonding costs help companies as well—without bonding, the public and state might seek to constrain corporate behavior ex ante, whether by burdensome contracts or regulation.[83]

B. The Public as the Primary Principal?

The previous Section described how to trace an agency relationship between the public and management. This Section considers the historical and theoretical evidence that supports giving the public interest primacy

80. For additional evidence of the problems that accompany government control of corporations, *see* Marcel Kahan & Edward B. Rock, *When the Government Is the Controlling Shareholder*, 89 TEX. L. REV. 1293 (2011).

81. Ethan Rouen, Kunal Sachdeva, & Aaron Yoon, *The Evolution of ESG Reports and the Role of Voluntary Standards* (August 11, 2023), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4227934 [https://perma.cc/8249-YWD6]; Elizabeth Peterson, Amanda Hoster, Matthew Novak, Yangshengjing Qiu, Sara Rosner, Shraddha Sawant, Alan Stautz, Laura Malo Yague & Qier Xue, *85% of S&P 500 Index Companies Publish Sustainability Reports in 2017*, GOVERNANCE & ACCOUNTABILITY INST., (Mar. 20, 2018), https://www.ga-institute.com/press-releases/article/flash-report-85-of-sp-500-indexR-companies-publish-sustainability-reports-in-2017.html [https://perma.cc/HNK4-KKYF].

82. *See id.* (discussing self-regulation in the nuclear power and chemical manufacturing industries). In addition, the U.S. securities industry is primarily governed by self-regulatory organizations. *Id.*

83. *See also* Sale, Social License, *supra* note 73.

in corporate law and governance. It then contrasts public primacy with other theories that seek to impute a public-facing obligation onto the corporation.

1. Corporate History

Although the idea of giving the public primacy in corporate law is unusual today, it would not have been to early corporations. To summarize a well-known history: Before the turn of the 20th century, a corporation could not operate without a state-granted charter, and the charter application process was demanding.[84] In particular, the state of incorporation would scrutinize the corporation's application and ensure that it planned to advance the public welfare or the interests of the state as a condition for granting the charter.[85] If granted, the charter limited the corporation to engaging only in a pre-specified single line of business, and charters that exceeded these boundaries were frequently revoked using a writ of *quo warranto*.[86] As such, during this period, the public was the clear beneficiary of the corporation's existence, and the state maintained strict control over the chartering process to ensure that the benefits of incorporation only accrued to entities that served the public.

From 1800 on, states began to diverge on the question of liberalizing the state charter process. Proponents of liberalization argued that charters should be available to any petitioning group—including those that offered no specific promise to benefit the public—because doing so would stimulate the economy, among other things. Some states ultimately subscribed to a modified version of that view: they granted charters more freely, but

84. *See generally* Shaw Livermore, *Unlimited Liability in Early American Corporations*, 43 J. POL. ECON. 674 (1935).

85. *Id.*; Harwell Wells, *A Long View of Shareholder Power: From the Antebelllum Corporation*, 67 FLA. L. REV. 1033, 1042 (2016) ("[I]n exchange for the 'privilege' of a charter, [the expectation was that] a corporation would provide some public service . . ."). The idea was that the benefits of incorporation should be given to businesses providing a public service that "neither the government nor an unincorporated firm could provide." *Id.* Therefore, charters generally went to institutions in the banking, turnpike, canal, and railroad industries—industries that offered substantial public benefits. *Id.*

86. E. Merrick Dodd, Jr., *The Modern Corporation, Private Property, and Recent Federal Legislation*, 54 HARV. L. REV. 917 (1941). The doctrine that limited corporate powers to those enumerated in the charter is known as the "ultra vires doctrine." The doctrine was a product of the view that corporations were creatures of the state and allowed special privileges, which entailed obligations to the public. Kent Greenfield, *Ultra Vires Lives! A Stakeholder Analysis of Corporate Illegality (With Notes on How Corporate Law Could Reinforce International Law Norms)*, 87 VA. L. REV. 1279, 1303 (2001). Courts also justified the doctrine as necessary to control corporate power and protect investors. *Id.* at 1302–04. As shareholder primacy rose to dominate the corporate law literature, the latter view was increasingly emphasized. *See, e.g.*, Michael Schaeftler, *Ultra Vires-Ultra Useless: The Myth of State Interest in Ultra Vires Acts of Business Corporations*, 9 J. CORP. L. 81 (1983).

when the public benefit was uncertain, refused to grant benefits such as perpetual existence or limited liability.[87]

Eventually liberalization won the day, and during the mid to late 1800s, state competition for charters began to take hold. Legislative charters were still the norm, but states began to offer favored corporations special terms—terms that were almost certainly not in the public interest.[88] To take one example, in 1830, New Jersey granted a railroad an exemption from all property taxes and protection from competition for nine years.[89] The purported goal in doing so was to keep business within the state, but the contractual terms were also the product of bribery and corruption.[90] Other examples of blatant corruption led to public hostility toward corporations and the states that chartered them. Put simply, it soon became clear that the state's power to grant charters, which emerged as a tool to ensure that corporations benefitted the public, was not furthering the public interest.[91]

This mismatch between state and public interest laid the foundation for the move toward general incorporation charters that characterized the late 1880s. New Jersey was the first to abandon legislative charters and offer corporations expansive rights and powers. For example, it permitted corporations to be formed for "any lawful business or purpose whatever" and allowed citizens of other states to form corporations in New Jersey.[92] The state also liberalized the laws governing the board of directors, giving them nearly unlimited power to manage the company, subject to judicial oversight for fraud.[93]

Accordingly, the result of this liberalization was the erosion of state control and the elevation of managerial control. But the reason for this evolution was not that it was no longer desirable to induce corporate management to serve the public; rather, the concept of how best to advance public welfare had changed. State-granted charters turned out to harm the public because of state agency costs: corrupt legislators used their power

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87. Livermore, *supra* note 84, at 675–76.

88. Charles M. Yablon, *The Historical Race Competition for Corporate Charters and the Rise and Decline of New Jersey: 1880–1910*, 32 J. CORP. L. 323, 331–32 (2006).

89. *Id.* at 331 n.31.

90. *Id.* at 332.

91. Schaeftler, *Ultra Vires-Ultra Useless*, *supra* note 86, at 87 ("The sovereign's monopoly over conferral of this valuable privilege inevitably led to the corruption of the legislative process. Public recognition of the abuses inherent in charter lobbying, together with widespread belief that the opportunity to incorporate should be equally available to all, fostered the decline of the special charter system.").

92. Yablon, *supra* note 88, at 334.

93. WILLIAM G. ROY, SOCIALIZING CAPITAL: THE RISE OF THE LARGE INDUSTRIAL CORPORATION IN AMERICA 166 (Princeton Univ. Press, 1999).

to give favored companies special perks in exchange for benefits.[94] As such, liberalizing the charter process and loosening state control was ultimately beneficial from a public welfare perspective—it would not only stimulate the local economy but also remove the potential for corruption that tainted the whole process.

And although the state of incorporation did cede control of corporate behavior in the chartering process, the government as a whole did not. Indeed, the period when corporate charters were liberalized corresponded with one of the fastest periods of growth of business regulation in history. The early 1900s witnessed the birth of federal antitrust enforcement and securities regulation, to take two important examples, and extensive corporate regulation as part of the New Deal followed shortly thereafter.[95] As such, public control of corporations shifted from enforcement by the state of incorporation to enforcement at the federal level—a push and pull that has persisted to this day.[96] Indeed, as Mark Roe has demonstrated, when state corporate law fails to constrain behavior that is detrimental to investors and the broader public, the federal government steps in to regulate corporate law and governance.[97] And this competition induces Delaware to ensure that its corporate law is not detrimental to the general public.[98] This history therefore supports the view that the promotion of public welfare has always been a core goal of corporate law, even though the means of achieving it have changed.

2. Fit with Theory

The previous sub-Section discussed how corporate law has evolved to promote the public interest throughout history. Of course, beginning in the 1990s, agency cost essentialists argued that promoting a focus on shareholders would promote the public interest for the reasons discussed in Part I. This sub-Section considers the two theoretical arguments at the

94. William L. Cary, *Federalism and Corporate Law: Reflections Upon Delaware*, 83 YALE L.J. 663, 663–64 (1974) ("In the early stages of the American economy there were grants of special franchises reminiscent of royal charters, but during the mid-nineteenth century there was a revulsion against them as anti-egalitarian, monopolistic, and scandalous.").

95. Laura Phillips Sawyer, *US Antitrust Law and Policy in Historical Perspective* (Harv. Bus. Sch., Working Paper No. 19-110, 2019), https://www.hbs.edu/faculty/Publication%20Files/19-110_e21447ad-d98a-451f-8ef0-ba42209018e6.pdf [https://perma.cc/D35T-ZKX7]; Adam C. Pritchard, *Corporate Governance, Capital Markets, and Securities Law*, *in* OXFORD HANDBOOK OF CORPORATE LAW AND CORPORATE GOVERNANCE 1063 (Jeffrey N. Gordon & Wolf-Georg Ringe eds., 2018); Wells, *supra* note 85, at 1065.

96. *See* Mark J. Roe, *Delaware's Competition*, 117 HARV. L. REV. 588 (2003).

97. *Id.* at 609 (explaining how states in the late 1800s competed to facilitate Standard Oil's monopoly which prompted Congress to pass the Sherman Act and take that authority away from the states).

98. *Id.*

core of the law and economics defense of shareholder primacy and shows how the same reasoning could support a public primacy orientation for corporate law.

First, law and economics scholars have justified shareholders' privileged status by deeming them the corporation's residual claimants—the individuals with the sole remaining claim on the organization's cash flows, who therefore bear residual risk and have a claim to the corporation's residual profits.[99] These scholars argued that this risk-bearing function explains why shareholders are entitled to important governance rights, like the right to vote on director elections.[100] Other parties hold fixed claims, and therefore have less need for control rights to protect themselves from risk and expropriation.[101] Additionally, scholars contend that marrying control rights with the residual claim would result in the best welfare outcomes for the corporation.[102] As residual claimants, shareholders are entitled to everything that is left after the company's contractual obligations are satisfied. Therefore, shareholders should have an incentive to use their monitoring and control rights to ensure that the corporation maximizes the value of the corporation, which would maximize the value of the residual claim.[103]

But scholars have since pointed out flaws in this analysis.[104] In particular, constituencies other than shareholders—employees, creditors, etc.—bear residual risk and yet lack control rights, which suggests that residual risk is not the reason for the existence of those rights.[105] Not only that, statutory shareholder control rights are quite limited. Yes, shareholders can vote management out of office, veto major transactions, inspect books and records, and sue for breach of fiduciary duty, but these rights do not allow shareholders to directly influence the company's operational strategy, detect shirking, or affect cash distributions that would affect the value of the residual claim.[106]

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99. *See, e.g.*, EASTERBROOK & FISCHEL, ECONOMIC STRUCTURE, *supra* note 5, at 36–39, 67.

100. *Id.*; Bernard Black, *Corporate Law and Residual Claimants* (Stan. L. Sch., Working Paper No. 217, 2001), https://escholarship.org/content/qt5746q7pj/qt5746q7pj.pdf [https://perma.cc/FPZ8-E9EH].

101. Oliver Williamson, *Corporate Governance*, 93 YALE L.J. 1197 (1984); EASTERBROOK & FISCHEL, ECONOMIC STRUCTURE, *supra* note 5, at 67.

102. EASTERBROOK & FISCHEL, ECONOMIC STRUCTURE, *supra* note 5, at 67.

103. *Id.*

104. Margaret M. Blair & Lynn A. Stout, *Specific Investment and Corporate Law*, *in* CORPORATE SOCIAL RESPONSIBILITY AND CORPORATE GOVERNANCE 99 (Lorenzo Sacconi, Margaret Blair, R. Edward Freeman & Alessandro Vercelli eds., 2010); Kent Greenfield, *The Place of Workers in Corporate Law*, 39 B.C. L. REV. 283, 305–11 (1998).

105. Black, *supra* note 100; Bratton, *Nexus of Contracts*, *supra* note 40.

106. Blair & Stout, *supra* note 104; Bainbridge, *Director Primacy*, *supra* note 38, at 27.

As for the welfarist claim, there is evidence to suggest that heightened shareholder control does not necessarily maximize firm value, nor do shareholders take only from the residual after the fixed claims are paid. Instead, it appears that shareholder control can lead the company to modify its contracts with contracting parties to increase the value that accrues to shareholders.[107] In other words, shareholder influence does not necessarily result in a larger pie, but an adjustment in the size of the portions that are served.[108]

Before turning to the second theoretical justification for shareholder primacy, pause for a moment to consider how the public would fare under this residual claimant analysis. Recall that scholars have pointed out that many corporate constituents bear residual risk. A less frequently observed fact is that the public is also a residual risk bearer. If a company is not profitable, the state and public will lose income in the form of tax revenue.[109] But more important, there are extra-contractual consequences: the state and public will be left shouldering the burdens of the corporation's lack of success—supporting unemployed workers, perhaps cleaning up environmental hazards, and more. Indeed, although all contracting parties bear residual risk, the state (and public) bear the most—employees, creditors, and shareholders are limited in the extent of their losses, whereas the public's risk of loss is potentially unlimited. As a vibrant example, consider what happened to Flint, Michigan after GM closed plants that

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107. Specifically, there is evidence that increased shareholder control allows shareholders to expropriate employee wealth by causing the company to reduce wages, cut jobs, and underfund pensions. *See, e.g.*, David Neumark & Steven A. Sharpe, *Hostile Takeovers and Expropriation of Extramarginal Wages: A Test* (NBER, Working Paper No. 4101, 1992), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=476189 [https://perma.cc/9M6D-YR64]; Marianne Bertrand & Sendil Mullainathan, *Is There Discretion in Wage Setting? A Test Using Takeover Legislation*, 30 RAND J. ECON. 535, 537 (1999) (finding that state antitakeover laws "raised annual wages by 1% to 2%, or about $500 per year"); Chialing Hsieh, Yi Ren & Roger Lirely, *Earnings Management, Executive Compensation and Layoffs*, 20 ACAD. ACCT. & FIN. STUD. J. 84 (2016); Anup Agrawal & Yuree Lim, Where Do Shareholder Gains in Hedge Fund Activism Come From? Evidence from Employee Pension Plans 1 (Feb. 2020) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3000596 [https://perma.cc/5SKK-FNCJ]; J. Adam Cobb, *Risky Business: The Decline of Defined Benefit Pensions and Firms' Shifting of Risk*, 26 ORG. SCI. 1332 (2015). There is also evidence that increased protection from shareholder influence results in greater management attention on the community and natural environment; by contrast, increasing sensitivity to shareholders discourages investments in corporate social responsibility, and environmental practices in particular. *See e.g.*, Aleksandra Kacperczyk, *With Greater Power Comes Greater Responsibility? Takeover Protection and Corporate Attention to Stakeholders*, 30 STRATEGIC MGMT. J. 261 (2009).

108. *Cf.* Henry Hansmann, *Ownership of the Firm*, 4 J.L. ECON. & ORG. 268, 276 (1988) (noting that owners "can easily and lawfully distribute to themselves any net earnings that accrue to the firm from exploiting patrons" and that they "have a much stronger incentive to engage in such exploitation than does management acting on its own").

109. Black, *supra* note 100, at 5 ("Federal, state, and local governments, as income, sales, and property tax collectors, are large residual claimants . . .").

employed over half of the city's population.[110] The loss of employment and tax revenue dealt a massive blow to the city, as did the exodus of people to the suburbs. Not only that, GM left behind environmental degradation that has since plagued residents and the local government.[111]

By the same token, the public has a residual interest in the corporation because it benefits from its success:[112] the public gains from increased employment, tax revenue, and so on. Importantly, the public does not benefit when a company focuses on short term gains at the expense of long-term viability, or takes shortcuts that create environmental or systemic risk.

Does the public maintain sufficient control over the corporation to maximize the value of the residual claim? Modern corporate codes provide the state with very few control rights, and the public none—the Delaware Code simply admonishes the corporation to abide by the law and retains rights to dissolve the corporation under certain circumstances.[113] Elsewhere however, the government retains substantial control over the corporation's business.[114] And while many of these requirements come in the form of regulation, some of them are quasi-contractual. Consider, for a moment, a corporation that seeks to do business in California, but that is incorporated in Delaware. The corporation will need to enter into a number of contracts with California that limit the corporations' operations and allow the state to collect revenue. For example, the corporation will need to apply for a license to do business,[115] and additional licenses may be required depending on the corporation's business activity: corporations that sell merchandise must apply for a seller's permit, while other permits

110. *See generally* David Rosner, *Flint, Michigan: A Century of Environmental Justice*, 106 AM. J. PUB. HEALTH 200 (2016).

111. This analysis also suggests a limiting principal for the public primacy standard. Providing shareholders with limited liability and control rights leads to moral hazard that can harm the public. As such, a corresponding duty to consider the public interest can help serve as a counterweight for organizations that provide limited liability to investors.

112. Black, *supra* note 100, at 5 (defining residual interest as involving a situation "in which the expected value of a contracting party's future dealings with the firm increases as the firm's value increases, and decreases as the firm's value decreases").

113. *See* DEL. CODE ANN. tit 8, § 141; § 510 (voiding a corporate charter for failure to pay tax); *Id.* § 322 (stating that the failure to obey a state decree or order is grounds for receivership).

114. For example, Delaware has detailed labor law, securities law, and environmental laws that govern a corporation's operations in Delaware. *See* DEL. OFF. OF LAB. L. ENF'T, https://dia.delawareworks.com/labor-law/ [https://perma.cc/9DA9-AJ49] (last visited July 12, 2020); DEL. DEP'T OF NAT. RES. & ENVTL. CONTROL, http://www.dnrec.delaware.gov/Admin/Pages/EnvironmentalEnforcement.aspx (last visited July 12, 2020); DEL. CODE ANN. Tit. 6, ch. 73.

115. Fitzpatrick, *supra* note 65; *Starting a Business*, CAL. SEC'Y OF STATE, https://www.sos.ca.gov/business-programs/business-entities/starting-business/ [https://perma.cc/66T7-46WE] (last visited July 12, 2020).

involve health, safety, and zoning requirements.[116] To secure the permit, the business will need to submit information that helps the state determine whether the business will help or harm public welfare. In addition, the state retains inspection rights—the right to monitor operations and ensure compliance with the law. It also retains the right to revoke the business license, which would prohibit the company from operating in the state. Therefore, in this example, California's maintains control over corporate operations to minimize residual risk but also enhance the public benefit. Ex ante, the state requires the corporation to apply for licenses and permits and commit to following its laws. Ex post, the state mandates periodic disclosure and inspection rights. If the corporation is deemed to be in violation of its obligations, the state can revoke licenses. This control ensures that corporate operations do not harm the public, and instead provide a benefit.

Note, however, that this descriptive account seeks only to explain how the state exerts influence over corporate activity to increase the value of the residual claim. It does not argue for increased state decision rights or control over corporate governance, which as the previous sub-Section revealed, would likely fail to promote the public interest. Indeed, the agency costs that compromise state contracting and influence suggest that a public-facing obligation for corporate management may be a beneficial substitute for increased state involvement in corporate governance. And as will be discussed in Part V, in the absence of adequate externality regulation, this obligation may be an important means of constraining anti-social corporate activity and promoting activity that is in the public interest.[117]

A second theoretical defense of shareholder primacy rests on the notion that it is the best means of securing managerial accountability. In particular, if fiduciaries were admonished to look out for public welfare, that would lead to an increase in agency costs that would destroy firm value. By contrast, the directive to focus on shareholder value is easy for outsiders to monitor and enforce. But shareholder primacy increases accountability to shareholders and thus improves accountability along a single dimension; as Part III makes clear, it does not address the divergence of interests between public welfare and corporate conduct.[118] The very difficult question that I will return to in Section III.C is whether and how a public

116. *California Licenses, Permits and Registration*, SMALL BUS. ADVICE, https://www.sba.com/california/licenses-permits/ [https://perma.cc/DT7Z-ETQ5 (last visited July 12, 2020).

117. *See also* Lund, *Toward a Dynamic View of Corporate Purpose*, *supra* n. 19.

118. Proponents of an "enlightened" shareholder value standard believe that fiduciaries should consider the interests and values of shareholders as individuals, such as their desire to breathe clean air. Such a view may reduce the wedge between public welfare and shareholder welfare. *See* Part III *infra*.

primacy objective could be fostered without substantially increasing the risk of managerial slack and self-dealing.

3. Relationship to Other Theories

The idea that corporate law should, as a core objective, minimize agency costs between the public and corporate management is related to other theories that seek to impute a public-facing obligation on corporations. For example, the concession theory views corporations as "creatures of law" created by the state. Concession theorists point to the corporation's early history, and state chartering in particular, and contend that it shows that the privilege of incorporation is linked to advancing the public good and welfare.[119] A related theory is known as the communitarian theory of corporate law, which emphasizes that vast corporate power warrants some consideration of the public interest.[120]

Unlike communitarian and concession theorists, this paper embraces the nexus of contracts theory of the firm.[121] The nexus of contracts theory is a mode of analysis that views corporate behavior as resulting from a complex contractual system (again using the loose institutional economics version of the term contract) made up of maximizing agents with diverse and conflicting objectives.[122] Indeed, in the classic contractarian model, the optimal equilibrium considers all contracting parties, not just shareholders and management.[123] My analysis recognizes that the state could also be considered an important contracting party, and that the state contracts with the corporation as an agent for the public. In other words, the state not only serves a public function by chartering corporations and

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119. *Id.*; Marty Lipton & Steven Rosenblum, *A New System of Corporate Governance: The Quinquennial Election of Directors*, 58 U. CHI. L. REV. 187 (1990); *see* Michael E. DeBow & Dwight R. Lee, *Shareholders, Nonshareholders and Corporate Law: Communitarianism and Resource Allocation*, 18 DEL. J. CORP. L. 393 (1993); Morton J. Horwitz, *Santa Clara Revisited: The Development of Corporate Theory*, 88 W. VA. L. REV. 173, 181 (1985) ("[T]he business corporation was regarded as an 'artifical [sic] being' created by the state . . . .").

120. David K. Millon, *New Directions in Corporate Law: Communitarians, Contractarians, and the Crisis in Corporate Law*, 50 WASH. & LEE L. REV. 1373, 1379 (1993) ("[C]orporations [are] more than just agglomerations of private contracts; they are powerful institutions whose conduct has substantial public implications."). A modern version of this theory is one that considers the "publicness" of corporations: "Although the freedom corporate actors enjoy is subject to laws and regulations, publicness, too, creates limits on the powers of those actors . . . ." Sale, Social License, *supra* note 73, at 5; *see also* Hillary A. Sale, *Public Governance*, 81 GEO. WASH. L. REV. 1012 (2013); Hillary A. Sale, *The New "Public" Corporation*, 74 LAW & CONTEMP. PROBS. 137 (2011).

121. *See* JONATHAN MACEY, CORPORATE GOVERNANCE: PROMISES KEPT, PROMISES BROKEN 22 (Princeton Univ. Press 2008) ("It has long been recognized . . . that the corporation . . . should be viewed as a 'nexus of contracts' or set of implicit and explicit contracts.").

122. *See* Michael C. Jensen & Clifford W. Smith, *Stockholder, Manager, and Creditor Interests: Applications of Agency Theory*, *in* RECENT ADVANCES IN CORPORATE FINANCE (Edward Altman & Marti G. Subrahmanyam eds, 1985).

123. *Id.*

adopting regulations to restrict activity, but also a somewhat private one—contracting with the corporation to ensure that the corporation acts to promote public welfare.

Public primacy can also be contrasted with a "team production" theory of corporate law offered by Margaret Blair and Lynn Stout.[124] According to their analysis, principal-agent theory is the wrong lens with which to understand publicly held corporations. Instead, corporate law can be understood as resolving team-production problems that arise when individuals invest firm-specific resources in the production of corporate goods but face contracting difficulties when it comes to specifying the distribution of the output of their joint efforts.[125] Although I agree with their analysis to the extent that it recognizes that corporate constituents other than shareholders contribute to corporate value, I believe that the agency model need not be discarded entirely; indeed, as discussed, agency analysis can encompass value that is contributed from stakeholders in addition to shareholders.

Public primacy can also be contrasted with "director primacy," which Stephen Bainbridge raised as an alternative to shareholder primacy.[126] Under Bainbridge's model, the board is more than a mere agent for shareholders, but a "sui generis" body with "original and undelegated power."[127] As a result, control rights and discretion should properly be vested with the board, not shareholders. However, even under this model, "directors are obliged to use their powers towards the end of shareholder wealth maximization."[128] In sum, director primacy does not reevaluate the ends of corporate law, but rather the means. As will be discussed in the next Part, a full embrace of public primacy would complicate both.

III. PUBLIC PRIMACY IN PRACTICE: OPEN QUESTIONS AND A PATH FORWARD

The previous sub-Section described how agency theory could be used to promote a broad conception of the corporation and its role in society. This Part makes this theoretical analysis concrete and considers what an embrace of public primacy might entail. Shareholders would, of course, still be a part of the welfare calculus and continue to be protected by their statutory voting rights. But rather than viewing shareholder welfare as an end, corporate management would consider it as a means of creating

124. Blair & Stout, *Team Production*, *supra* note 4.
125. *Id.*
126. Bainbridge, *Director Primacy*, *supra* note 38.
127. *Id.* at 3 (citing Manson v. Curtis, 119 N.E. 559, 562 (N.Y. 1918)).
128. *Id.*

corporate value for the benefit of the public—the ultimate goal.[129] Importantly, corporate law and governance would need to evolve to promote accountability to this end goal. The sub-Sections that follow contain more detail about what an embrace of a public primacy standard might look like for corporate law and governance.

A. Fiduciary Discretion

Suppose for a moment that the Delaware Supreme Court announced in a judicial opinion that the purpose of the corporation is to promote the value of the corporation for the benefit of the public,[130] solidifying a public primacy standard as the lodestar for fiduciary decisionmaking. Even in this scenario, much would remain the same: fiduciaries would still be bound by the duty of care and of loyalty, and shareholders would continue to have the right to vote on director elections, veto major corporate transactions, and bring shareholder proposals. Accordingly, shareholders would continue to have core protections for their interests under law.

But do those protections render the public primacy standard meaningless? No: as many have observed, even under a strict shareholder primacy standard, fiduciaries have ample discretion under the business judgment rule.[131] According to some scholars, this discretion means that fiduciaries could legally sacrifice profits to benefit the public so long as there was some rational nexus to profit maximization at some point in the future.[132] And yet, the legal directive seems to matter a great deal. For one, in a world of choices, the knowledge that you are legally required to advance one goal surely focuses attention and effort. In addition, fiduciaries

129. Note that this is the opposite of how shareholder primacy works today, where considering the public interest is a means of achieving shareholder value.

130. Although many argue that directors are obligated to pursue shareholder value, there is some dispute. *See* Robert J. Rhee, *A Legal Theory of Shareholder Primacy*, 102 MINN. L. REV. 1951 (2017); Cynthia Williams, *The Future of Shareholder Wealth Maximization: A Response to George Mocsary*, LAW & LIB. (Dec. 23, 2013), https://lawliberty.org/forum/the-future-of-shareholder-wealth-maximization-a-response-to-george-mocsary/ [https://perma.cc/3TAC-C24D]; STOUT, SHAREHOLDER VALUE MYTH, *supra* note 38. But even accepting that the law requires shareholder value maximization, legal change might not be necessary to move corporate behavior in a public primacy direction. If the norms for director and officer behavior evolved, that change alone could induce management to exercise their broad discretion for the benefit of the public. That being said, legal change would be a more expedient way to bring about change, and in particular, alterations to the existing shareholderist corporate governance infrastructure, which the next sub-Section discusses in greater detail. *See* Cynthia Williams & Ruth Aguilera, *Corporate Social Responsibility in a Comparative Perspective*, *in* OXFORD HANDBOOK OF CORPORATE SOCIAL RESPONSIBILITY 452, 454 (Andrew Crane, Dirk Matten, Abigail McWilliams, Jeremy Moon & Donald S. Sigel eds., 2008) (discussing how legal standards "have a particularly strong influence on establishing social expectations about responsible corporate behavior" and create a focal point for other institutional players to interact and create standards).

131. Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733 (2005); STOUT, SHAREHOLDER VALUE MYTH, *supra* note 38.

132. Elhauge, *supra* note 131.

tend to be advised by legal counsel, which advise that in order to "stay on the shareholder primacy path," fiduciaries should "make an independent, disinterested and informed business judgment in good faith, looking solely to the economic best interests of shareholders as a whole."[133]

In other words, a move to a public primacy standard could influence how fiduciaries exercised their ample discretion. The lodestar would no longer be shareholder value, but public benefit. For an example of how this standard could affect decision-making, consider the following stylized example. Imagine that the pharmaceutical company Gilead has developed a COVID-19 treatment that will dramatically improve outcomes and reduce the length of hospital stays for infected individuals. How will the executive team price the drug? Under the existing standard which looks solely at the economic best interests of shareholders, the company would be encouraged to raise the price as high as it legally could, regardless of the fact that doing so would render the drug unavailable to people in the developing world and parts of the developed world.[134] By contrast, under a public primacy standard, the executive team might price the drug high enough to cover development costs and ensure some shareholder return, but lower than under the alternative regime because an exorbitant price would not provide as large a public benefit.[135]

Of course, it is possible that even in a shareholder primacy world, management could price the drugs reasonably under the guise that doing so promoted long-term shareholder value. So long as the choice was not overtly counter to shareholder interests, management would be protected by the business judgment rule.[136] Likewise, even in a public primacy

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133. Peter Atkins, Marc Gerber & Edward Micheletti, Skadden Arps LLP, *Social Responsibility and Enlightened Shareholder Primacy: Views from the Courtroom and Boardroom*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Feb. 21, 2019), https://corpgov.law.harvard.edu/2019/02/21/social-responsibility-and-enlightened-shareholder-primacy-views-from-the-courtroom-and-boardroom/ [https://perma.cc/DZ4Y-ZKPX].

134. *See, e.g.*, Andrew Pollack & Sabrina Tavernise, *Valeant's Drug Price Strategy Enriches It, But Infuriates Patients and Lawmakers*, N.Y. TIMES (Oct. 4, 2015), https://www.nytimes.com/2015/10/05/business/valeants-drug-price-strategy-enriches-it-but-infuriates-patients-and-lawmakers.html (quoting Valeant CEO as stating that "he has a duty to shareholders to wring the maximum profit out of each drug").

135. David J. Berger, *In Search of Lost Time: What if Delaware Had Not Adopted Shareholder Primacy?*, *in* THE CORPORATE CONTRACT IN CHANGING TIMES 49 (Steven Davidoff Solomon & Randall Thomas eds., Univ. of Chicago Press, 2017) (quoting Merck CEO as saying in the 1950s that the purpose of Merck was to develop medicine for the patient: "We try never to forget that medicine is for the people. It is not for the profits."). As additional evidence, note that pharmaceutical companies funded by the government (and that have therefore embraced a commitment to the public) have committed to pricing COVID-19 vaccines at cost, whereas those that have not have made no such promise. *See* Katherine Wu, *Some Vaccine Makers Say They Plan to Profit From Coronavirus Vaccine*, N.Y. TIMES (July 21, 2020), https://www.nytimes.com/2020/07/21/health/covid-19-vaccine-coronavirus-moderna-pfizer.html.

136. *See* Elhauge, *supra* note 131, at 770.

world, management could price-gouge on the grounds that high prices will fuel future drug development in the public interest. The point is not that these choices are impossible, only that they are less likely when the legal standard asks fiduciaries to advance a different end goal.

In sum, a public primacy standard could encourage fiduciaries to consider social welfare more fully when making decisions. In addition, an embrace of public primacy could help reconcile tension that currently exists in corporate law. As an example, look to the states that have adopted constituency statutes that explicitly allow management to consider the interests of a broader subset of corporate constituents when making decisions.[137] These statutes were adopted in the wake of the hostile takeover wave, and specifically, the Delaware Supreme Court's *Revlon* decision.[138] Thirty-two state legislators responded to that decision with legislation intended to permit corporate managers to consider stakeholder interests even when the company was for sale.[139] And yet, a puzzling judicial response followed: most state courts interpreted these statutes through a shareholder primacy lens, concluding that they simply enabled management to promote long-term shareholder value.[140] If public primacy was viewed as the dominant model for corporate law, courts would have a harder time marginalizing these legislative pronouncements.

Another source of tension is evident when reflecting on the federal government's response to corporate crises. For example, consider the Dodd-Frank Act of 2010, which was adopted in the wake of the financial crisis of 2008.[141] Many faulted shareholder primacy for contributing to the environment of moral hazard that brought down the global economy,[142] and yet, Dodd-Frank included multiple reforms that strengthened shareholder control over corporate decisionmaking. In particular, Dodd-Frank provided shareholders an advisory vote on executive compensation and gave the SEC the authority to adopt a proxy access rule that would allow

137. Stephen M. Bainbridge, *Interpreting Nonshareholder Constituency Statutes*, 19 PEPP. L. REV. 991 (1992).

138. *Id.*; Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986).

139. Neetal Parekh, *What Is a Constituency Statute*?, INNOV8SOCIAL (Aug. 27, 2011), https://www.innov8social.com/2011/08/what-is-constituency-statute [https://perma.cc/PT33-QMVF].

140. *See* George Mocsary, *Freedom of Corporate Purpose*, 2016 B.Y.U. L. REV. 1319, 1359–62 ("The statutes appear, with some exceptions around the edges and one caveat, to line up rather consistently behind allowing corporate boards to consider nonshareholder interests provided that long-term shareholder wealth is the ultimate goal.").

141. The Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

142. Mike Marin, *The Crisis of Shareholder Primacy*, UNIV. CAMBRIDGE: RSCH. (Mar. 19, 2012), https://www.cam.ac.uk/research/discussion/the-crisis-of-shareholder-primacy [https://perma.cc/3D3S-3FAX]; Yair Listokin & Inho Andrew Mun, *Rethinking Corporate Law During a Financial Crisis*, 8 HARV. BUS. L. REV. 351 (2018).

shareholders to directly nominate directors to the company's proxy statement.[143] In other words, problems that were exacerbated by shareholder influence were addressed by giving shareholders greater control. The reason, of course, is that shareholder control is often viewed as the sole means of controlling management myopia and entrenchment. And as will be discussed in the next Section, a move toward public primacy could change the form and content of reform intended to curb managerial self-interest and anti-social corporate behavior—rather than simply viewing shareholder control as a one-way ratchet, public primacy might encourage other mechanisms for increasing accountability and minimizing myopia for the public's benefit.

Finally, public primacy provides a more complete unifying standard for corporate purpose than shareholder primacy. This is because not all corporations have shareholders—nonprofits, for example, are not permitted to have any.[144] Likewise, it would be strange to describe state or government-owned firms, as well as worker and consumer-owned firms that require no capital investment, as operating for the benefit of their shareholders.[145] By contrast, all of these forms of business could be viewed as operating to promote public welfare—whether by creating sustainable jobs and generating wealth for workers, or by improving the quality of life for members of the community.

B. Path of Governance Reform

Although corporate law certainly influences fiduciary conduct, extralegal institutional structures may be even more important. As Elizabeth Pollman and I have written, a "corporate governance machine" enshrines shareholder primacy from multiple vantage points—not only in law, but also through culture and markets.[146] As a result of this system, most public companies are devoid of standing takeover defenses, have a substantial fraction of independent directors on the board, and pay their executive team in equity-based compensation.[147] And the overall result is that management rarely uses its discretion to benefit stakeholders, unless doing so is consistent with shareholder wealth maximization.[148]

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143. MICHAEL J. BARRY & JOHN C. KAIRIS, GRANT & EISENHOFER P.A., SHAREHOLDER RIGHTS AND CORPORATE GOVERNANCE IN THE DODD-FRANK ACT (2011), https://www.gelaw.com/ge/articles/Shareholder-Rights-Dodd-Frank.pdf [https://perma.cc/VJU7-VSH3].

144. *See* Henry Hansmann, *Reforming Nonprofit Corporation Law*, 129 U. PA. L. REV. (1980).

145. Hansmann, *Ownership of the Firm*, *supra* note 108.

146. Lund & Pollman, *supra* note 2.

147. *Id.*

148. Bebchuk & Tallarita, *supra* note 2 (manuscript at 4) (studying acquisitions in states with constituency statutes and showing that few companies use their additional discretion to benefit stakeholders).

But the corporate governance machine was not constructed overnight: instead, it is the product of several decades of corporate governance reform in the wake of the widespread acceptance of agency cost essentialism.[149] Over time, the orientation of these reforms has become inevitable. But corporate governance is capable of rapid change. Consider, as just one example, how the rise of hostile takeovers in the 1980s made the poison pill nearly ubiquitous at public companies by the end of the decade.[150] And perhaps the corporate governance machine could loosen its shareholder primacy grip if a new model took its place.[151]

What would corporate governance reform from a public primacy direction entail? There are many possibilities. For one, perhaps the board of directors would no longer be asked to monitor management for the benefit of shareholders, but for the public. This could induce the stock exchanges to move away from strict independence requirements in their listing standards; likewise, federal legislation could de-emphasize director independence and shareholder value as the lodestar for good governance.[152] Instead, the board might be urged to include a subset of directors with knowledge and expertise relevant to managing the corporation's impact on society—the environment, workers, or representatives from the community.

Second, executive compensation might evolve to promote consideration of the public interest. Companies increasingly tie compensation to ESG metrics, although those that have done so tend to link only a small fraction of pay to these metrics.[153] But if public primacy took hold, this could change: Instead of tying 5% of executive pay to ESG metrics and 50% to stock price, those percentages might be switched. That is not to say that designing compensation to incentivize attention to the public interest would be easy to do. But note that the alternative is not so simple either: it is challenging to craft executive pay packages that encourage long-term shareholder value maximization without distorting decision-making.[154] In the past thirty years, a consulting industry has developed to

149. Lund & Pollman, *supra* note 2.

150. *See id.*

151. This Article primarily considers how extra-legal corporate governance requirements might change under a public primacy regime, although the embrace of public primacy could also cause legal rules to evolve as well. For example, securities law could usefully mandate disclosure of information about the company's impact on the public, which would facilitate monitoring and enforcement. *See* Ann M. Lipton, *Not Everything Is About Investors: The Case for Mandatory Stakeholder Disclosure*, 37 YALE J. ON REG. 499 (2020).

152. *See* Gordon, *Rise of Independent Directors*, *supra* note 50.

153. Jessica Tasman-Jones, *Investor Backlash Against ESG Hit Executive Compensation*, FIN. TIMES, https://enterprise.ft.com/en-gb/blog/investor-backlash-against-esg-hits-executive-compensation/.

154. Bebchuk & Tallarita, *supra* note 2; LUCIAN BEBCHUK & JESSE FRIED, PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION (Harvard Univ. Press, 2006).

help corporations respond to these challenges, as has an entire academic literature. In time and with similar effort, it is surely possible that companies could find a satisfactory way to encourage executives to consider a broader set of interests.

What would be the shareholder wealth effects of these changes? My assumption is that they would be minimal in aggregate. For some companies, inducing management to consider the public interest would negatively affect the share price, for others, it would increase it.[155] Indeed, there is a growing consensus that considering the public interest is an important means of securing long-term shareholder value.[156] I recognize, however, that not all shareholders would benefit under a public primacy regime. For example, a company that had been transferring value to shareholders at the expense of its workers might see its share price fall if it altered this practice. Therefore, a true embrace of public primacy would likely entail some protection from shareholder influence. Otherwise, public primacy could easily be reversed by a wealthy shareholder who could purchase the company and run it differently.[157]

Accordingly, management might be entitled to adopt some form of protection—a staggered board, a poison pill, dual-class stock, etc. Of course, these governance devices do not protect management from all forms of shareholder influence—shareholders can still sue for breach of fiduciary duty, they can still exit, and they can still veto transactions and vote on director elections. In addition, large shareholders can still have a dialogue with management about their plans, and management will have an incentive to keep them happy—management does not usually benefit when the company alienates its shareholders.[158] However, the fact remains

155. *See* Martijn Cremers, Scott Guernsey & Simone Sepe, Stakeholder Orientation and Firm Value (Dec. 30, 2019) (unpublished manuscript) (finding that the adoption of constituency statutes results in significant increases in shareholder value for affected firms in innovative industries and where stakeholder investments are most relevant).

156. *See*, *e.g.*, Rodgin Cohen, *It's Good for Shareholders When Boards Consider the Public Interest*, FIN. TIMES (Oct. 15, 2019), https://www.ft.com/content/40e06550-ee72-11e9-a55a-30afa498db1b; Shawn L. Berman, Andrew C. Wicks, Suresh Kotha & Thomas M. Jones, *Does Stakeholder Orientation Matter? The Relationship Between Stakeholder Management Models and Firm Financial Performance*, 42 ACAD. MGMT. J. 488 (1999); Sandra A. Waddock & Samuel B. Graves, *The Corporate Social Performance-Financial Performance Link*, 18 STRATEGIC MGMT. J. 303 (1997); Silvia Ayuso, Miguel Angel Rodríguez, Roberto García & Miguel Angel Ariño, *Maximizing Stakeholders' Interests: An Empirical Analysis of the Stakeholder Approach to Corporate Governance* (IESE Bus. Sch., Working Paper No. 670, 2007), https://media.iese.edu/research/pdfs/DI-0670-E.pdf [https://perma.cc/VS5G-GPC4]; *see also* Sale, Social License, *supra* note 73.

157. *See* Oliver Hart & Luigi Zingales, *Companies Should Maximize Shareholder Welfare Not Market Value* (ECGI Fin., Working Paper No. 521/2017, 2017), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3004794 [https://perma.cc/JG7A-WWD9].

158. Large shareholders are more influential today than ever before and regularly engage with management. *See, e.g.*, Lucian A. Bebchuk & Scott Hirst, *The Specter of the Giant Three*, 99 B.U. L. REV. 721 (2019).

that protection from a takeover or proxy contest, which may be necessary to protect the public primacy objective at certain companies, also raises the specter of managerial entrenchment and the negative weath and welfare effects that follow. The next sub-Section addresses these concerns.

C. Implementation, Accountability, and Alternatives

Thus far, my analysis has assumed that management could and would serve the interests of the public. But agency theory advises that we cannot be so sure, and that shareholder primacy might in fact be the best means of maximizing overall welfare because of managerial agency costs.[159] According to this argument, shareholder primacy not only provides a clear mandate for management, it facilitates monitoring and enforcement, reducing the prospect of managerial slack and self-dealing.[160] By contrast, directing management to maximize the interests of a broader group would be difficult for management to accomplish and could lead to an erosion in accountability, destroying corporate value (and social welfare) in the process.[161] The sub-Sections that follow begin to unpack how these implementation issues could be handled, comparing managerial decisionmaking under a public primacy standard to the current state of affairs.

1. Implementation by Management

Implementing public primacy would require difficult decisions: which interests would be considered as part of public welfare? How would trade-offs between groups be resolved? How could management evaluate success or failure?

Although resolving these questions would surely be challenging, they are not impossible.[162] At the outset, consider that shareholder primacy itself entails a number of difficult considerations and tradeoffs. Although economists at one point viewed shareholders as essentially interchangeable,[163] today we know differently. Shareholders are heterogenous on a number of dimensions—their time horizons, their risk aversion, and even their values.[164] Therefore, even the simple act of maximizing shareholder value entails difficult judgment calls, too. Imagine a firm that is considering whether to spin off a division of the company, which would boost the

159. *See* notes 104–06 *supra* and accompanying text.

160. *See* Hansmann & Kraakman, *supra* note 40; Bebchuk, *Increasing Shareholder Empowerment*, *supra* note 51.

161. *Id.*

162. Bebchuk & Tallarita, *supra* note 2.

163. Easterbrook & Fischel, *Voting in Corporate Law*, *supra* note 41, at 405 (arguing that shareholder interests are "similar if not identical").

164. Iman Anabtawi & Lynn Stout, *Fiduciary Duties for Activist Shareholders*, 60 STAN. L. REV. 1255 (2008); Scott Hirst, *Social Responsibility Solutions*, 43 J. CORP. L. 217 (2017).

stock price immediately but have questionable effects on long-term profitability. Should management prioritize the interests of a vocal hedge fund with a 2% stake, or the company's broadly diversified index investors with longer time horizons? Should management consider that a growing fraction of the company's shareholder base is composed of ESG funds that would favor a spin-off of a division with harmful environmental effects? What about the retail shareholders who are less risk tolerant than diversified mutual fund investors? Clearly, shareholder primacy also entails trade-offs and difficult decisions.

Not only that, to avoid inducing short-termism, the dominant standard for shareholder primacy has evolved away from share price maximization and toward long-term shareholder value maximization, which has introduced further complexity and also laid the foundation for public primacy.[165] In particular, many adherents of this "enlightened" standard urge fiduciaries to consider stakeholder value and the public interest as a means of securing long-term shareholder value.[166] In other words, the leading view of shareholder primacy contemplates that management can and should evaluate whether corporate activity is in the public interest as a means of long-term shareholder value creation. Therefore, it is a simple leap to ask management to pursue public interest as an end goal, because giving thoughtful attention to the public interest is something management ought to have been doing already.

As with an enlightened shareholder value standard, I anticipate that public primacy would involve a relatively consistent set of considerations: management could consider the effects of corporate decisions on employees, creditors, shareholders, suppliers, customers, and the broader community. But doing so would not be viewed as a means of securing shareholder value or even stakeholder value; instead, the goal would be to create corporate value that benefits the public.[167]

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165. *See* Dorothy S. Lund, *Enlightened Shareholder Value, Stakeholderism, and the Quest for Managerial Accountability*, *in* RESEARCH HANDBOOK ON CORPORATE PURPOSE AND PERSONHOOD 91 (Elizabeth Pollman & Robert Thompson eds., 2021).

166. Harper Ho, *"Enlightened Shareholder Value": Corporate Governance Beyond the Shareholder-Stakeholder Divide*, 36 J. CORP. L. 59 (2010); Lund, *supra* note 165.

167. In this way, public primacy could be easier to implement than a stakeholder governance model, which generally directs management to maximize total stakeholder value and has been criticized as lacking guidance for fiduciaries who must address conflicts between stakeholders. *See* Andrew Keay, *Stakeholder Theory in Corporate Law: Has It Got What It Takes?*, 9 RICH. J. GLOB. L. & BUS. 249, 263 (2010); Bebchuk & Tallarita, *supra* note 2. For example, the decision to build a new factory could harm the environment but benefit workers; as such, simply asking management to maximize stakeholder value provides little guidance on how management should think about that decision. By contrast, public primacy sets forth the company's public benefit as a lodestar and therefore offers a means of resolving the decision.

But, how would management determine which corporate actions promote corporate value for the benefit of the public? Most likely, management would give substantial thought to this goal in advance, considering which stakeholder groups and objectives to prioritize. And then, on a day-to-day basis, management would proceed as they do under a shareholder primacy standard: by using their discretion to navigate complicated strategic choices, in the service of corporate value and public welfare. Although success would be harder to measure—a fall or increase in stock price might not tell the whole story—management (and third parties) could develop standards to aid themselves in implementation. Management could also bond themselves to third party certification programs to help ensure that the corporation is acting consistently with public welfare.[168]

In sum, implementing public primacy would require additional complexity, but with time and effort, companies (aided by consultants and academic research) could likely implement a set of best practices and standards to help them discharge their duty.

2. Accountability

A larger concern is that the increase in discretion that would accompany a meaningful shift to public primacy would lead to an erosion in accountability that would harm corporate value and social welfare. The classic belief is that "a manager told to serve two masters (a little for the equity holders, a little for the community) has been freed of both and is answerable to neither. Faced with a demand from either group, the manager can appeal to the interests of the other. Agency costs rise and social wealth falls."[169] And these concerns are not unfounded. As Section II.B discussed, insulation from shareholder pressure might be necessary to allow management room to maximize the value of the corporation for the benefit of the public. Relatedly, public primacy could reduce a company's share price. This could be because the company's stock price had previously been propped up due to expropriation by shareholders, or again, it could be because of inefficiencies and self-dealing that harm both the corporation and the public.

As a result, managerial accountability is a chief concern. But if the core agency problem involves slack between the public interest and management, shareholder control reduces only a subset of those agency costs and does not address others. Indeed, by inducing excessive risk taking,

168. B Lab has a certification program that does something similar now. *Certification*, B PROGRAM, https://www.bcorporation.net/en-us/certification/ [https://perma.cc/2KK8-VM47] (last viewed Aug. 17, 2020).

169. EASTERBROOK & FISCHEL, ECONOMIC STRUCTURE, *supra* note 5, at 38.

manipulation, and even illegal behavior, a shareholder primacy standard exacerbates certain agency problems between management and the public.

Therefore, in a public primacy world, it would be necessary to design accountability mechanisms to promote fidelity to the end goal. I believe that this would be challenging but not impossible. Consider the evolution in executive compensation and other devices designed to constrain management agency costs that has occurred over the past four decades. Today, an entire industry of compensation consultants is devoted to designing executive compensation packages that incentivize managerial responsiveness to shareholder interests, and advising boards of directors (and specifically, the compensation committee) on how to discharge their duties. These consultants and advisors could also aid companies in discharging their obligations under a public primacy mandate. In fact, they have already begun to do something like this: in light of evidence that tying pay to the company's stock price contributes to short-termism,[170] compensation consultants increasingly rely on long-term value creation metrics, including measures of stakeholder value.[171] This evolution suggests that the foundation for a shift to public primacy is already being laid. And as Section III.B. discussed, corporate governance could further evolve to support a public primacy objective, which could ultimately lessen concerns about accountability.

As further support for the view that public primacy would not necessarily lead to an increase in agency costs that would drastically erode corporate value, note that the convergence hypothesis offered by Henry Hansmann and Reinier Kraakman at the turn of the 21st century has not materialized.[172] Their prediction was that alternative governance models—such as the labor-oriented model in Germany—would slowly converge on a shareholder primacy framework in light of its unparalleled efficiencies.[173] But today, divergence in corporate governance continues, and corporate law in several wealthy and developed countries—including France, Germany, and Scandinavia—continues to eschew shareholder primacy by directing management to consider the interests of shareholders, employees,

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170. *See, e.g.*, John C. Coffee Jr., *Understanding Enron: "It's About Gatekeepers, Stupid"*, 57 BUS. LAW. 1403, 1413–14 (2002) ("Stock options create an obvious and potentially perverse incentive to engage in short-run, rather than long-term, stock price maximization because executives can exercise their stock options and sell the underlying shares on the same day.").

171. *Use Best Practices in Executive Compensation Plans*, J. ACCOUNTANCY (May 31, 2002), https://www.journalofaccountancy.com/issues/2002/jun/usebestpracticesinexecutivecompensation-plans.html [https://perma.cc/5FF2-WTXZ].

172. *See* Hansmann & Kraakman, *supra* note 40, at 440.

173. *Id.*

and society as a whole.[174] And although it is difficult to determine which standard has better promoted corporate value, the companies in these countries have done just fine. To take just one example, Toyota outperformed GM from 1976 to 2006, despite being governed by a stakeholder governance model during that time period.[175] All in all, continued divergence in governance models suggests that shareholder control is not the only means of promoting managerial accountability in governance.[176]

3. Governance vs. Regulation

Finally, although shareholder primacy advocates believe that public welfare is a laudable goal, they view its achievement as outside the bounds of corporate law and governance. Regulation exists to control corporate behavior that harms the public; therefore, corporate governance should not be concerned with pollution, layoffs, and other corporate choices that are profitable but lead to social harm.[177] Indeed, some contend that by mixing governance and public welfare, the onus for beneficial externality regulation would be removed.[178] If corporate leaders are viewed as taking social

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174. Leo E. Strine, Jr., *The Soviet Constitution Problem in Comparative Corporate Law: Testing the Proposition that European Corporate Law Is More Stockholder Focused than U.S. Corporate Law*, 89 S. CAL. L. REV. 1239 (2016); Franklin Allen, *Corporate Governance in Emerging Economies*, 21 OXFORD REV. ECON. POL'Y 164, 167 (2005).

175. Franklin Allen & Mengxin Zhao, The Corporate Governance Model of Japan: Shareholders Are Not Rulers (May 13, 2007) (unpublished manuscript), http://finance.wharton.upenn.edu/~allenf/download/Vita/Japan-Corporate-Governance.pdf. Companies operating as benefit corporations in the United States have also performed well. *See* Ayuso, Rodríguez, García & Ariño, *supra* note 156 (mentioning companies that have become more valuable since becoming B Corps); Alex Buerkle, Max Storto & Kylee Chang, *Just Good Business: An Investor's Guide to B Corps*, YALE CTR. FOR BUS. & ENV'T (Mar. 14, 2018), https://cbey.yale.edu/our-stories/the-value-of-b-corps-what-investors-need-to-know [https://perma.cc/88FJ-7VJB] ("Certified B Corporations demonstrated a greater revenue growth rate than public firms of comparable size from 2006 to 2011—a period that includes the Great Recession.").

176. *See* Hansmann, *supra* note 108, at 277 ("Indeed, large groups of firms have prospered over long periods of time in competitive environments without any effective exercise of control by owners whatsoever—and even without any owners.").

177. EASTERBROOK & FISCHEL, ECONOMIC STRUCTURE, *supra* note 5; *see also* STEPHEN M. BAINBRIDGE, CORPORATION LAW AND ECONOMICS 425 (2002) ("Corporate conduct doubtless generates negative externalities. In appropriate cases, such externalities should be constrained through general welfare legislation, tort litigation, and other forms of regulation."); Hansmann & Kraakman, *supra* note 40; Jeffrey N. Gordon, *Addressing Economic Insecurity: Why Social Insurance Is Better than Corporate Governance Reform*, COLUM. L. SCH. BLUE SKY BLOG (Aug. 21, 2019), https://clsbluesky.law.columbia.edu/2019/08/21/addressing-economic-insecurity-why-social-insurance-is-better-than-corporate-governance-reform/ [https://perma.cc/N92T-ABKY]; Friedman, *supra* note 25 ("[T]here is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud.").

178. Bebchuk & Tallarita, *supra* note 2.

welfare into consideration, advocates and legislators alike will view regulation as less of a priority.[179]

As a threshold matter, the argument that government regulation is capable of controlling negative corporate externalities is on tenuous ground,[180] and shareholder primacy is partially to blame. Legislation is influenced by corporate lobbying and contributions,[181] and corporations have an incentive to thwart legislation that would eat away at shareholder returns—such as by requiring them to reduce pollution or protect employees.[182] Indeed, some have argued that corporations have a "duty" to lobby "to shape the rules of the game to their own advantage."[183] This reality is a direct consequence of shareholder primacy, and the welfare implications are clear: corporations are unlikely to be bound by rules that are optimal from a public welfare standpoint.

In other words, shareholder primacy has not put the onus on regulators to increase the severity of corporate regulations; by contrast, it has made regulators more beholden to corporations and their shareholders' interests. By the same token, relaxing the shareholder primacy norm in favor of public primacy could be expected to have the inverse effect. Indeed, it would be difficult to impute a duty to lobby for shareholder welfare at the exclusion of public welfare under such a standard.

And for as long as regulation fails to control corporate behavior that creates negative externalities, the argument for using corporate purpose to control corporate harm strengthens.[184] Indeed, this is one of the lessons

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179. *Id.*

180. *See* note 77 *supra* and accompanying text.

181. Nathan Grasse & Brianne Heidbreder, *The Influence of Lobbying Activity in State Legislatures: Evidence from Wisconsin*, 36 LEGIS. STUD. Q. 567 (2011).

182. JOHN CRAIG & DAVID MADLAND, CTR. FOR AM. PROGRESS, HOW CAMPAIGN CONTRIBUTIONS AND LOBBYING CAN LEAD TO INEFFICIENT ECONOMIC POLICY (May 2, 2014), https://www.americanprogress.org/issues/economy/reports/2014/05/02/88917/how-campaign-contributions-and-lobbying-can-lead-to-inefficient-economic-policy/ [https://perma.cc/D9EG-GNDD] (observing that corporate lobbying makes up 72% of lobbying expenditures and that "businesses that are most likely to make contributions or lobby are also those with the highest payoffs from favorable policy decisions, providing credence for the position that business political activity is to a significant degree about rent-seeking"); Richard L. Hasen, *Lobbying, Rent-Seeking, and the Constitution*, 64 STAN. L. REV. 191 (2012).

183. Luigi Zingales, *Does a CEO Have a Duty to Lobby?*, PROMARKET (Apr. 11, 2016), https://promarket.org/2016/04/11/does-a-ceo-have-a-duty-to-lobby/ [https://perma.cc/AR26-GYW6].

184. Dorothy Lund, Toward a Dynamic View of Corporate Purpose, *supra* n. 19; Elhauge, *supra* note 131, at 738–39 (arguing that law cannot optimally regulate corporate conduct, and managers need discretion to act in the public interest to correct this deficiency); *see also* Jill E. Fisch & Steven Davidoff Solomon, *Should Corporations Have a Purpose?* 16 (ECGI L., Working Paper No. 510/2020, 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3561164 [https://perma.cc/76UJ-K38A] ("[E]ven if shareholder value is correlated with firm value, [the shareholder primacy view can be challenged by recognizing that, as a practical matter,] some societal interests will not fall within the

gleaned from the early period of corporate law in the U.S.: when the nascent federal government had little means of protecting the public against unfair competition, unfair labor practices, and excessive pollution, the state maintained tight control over corporate governance in order to ensure that the privilege of incorporation was reserved for companies that provided a public benefit.[185] That control was only loosened when it was clear that state control was not promoting the public interest, and when the federal government stepped in to pick up the slack.[186] However, with increasing evidence of suboptimal externality regulation, the onus is again placed on corporate governance.

CONCLUSION

This Article explores the malleability of agency theory by showing that it could be used to justify a "public primacy" standard for corporate law that would direct fiduciaries to promote the value of the corporation for the benefit of the public. Employing agency theory in this way sheds light on aspects of firm behavior, as well as the nature of state contracting with corporations. It also provides a lodestar for a possible future evolution of corporate law and governance: minimize the agency costs created by the divergence of interests between management and the public.

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contours of the firm. To the extent that maximizing shareholder (or firm) value sacrifices these interests, that operating policy creates negative externalities. Economic theory does not supply an answer to the normative question of how corporate law or individual operational decisions should weigh these costs, but any broad-based efficiency theory must grapple with them."); Edward Rock, *For Whom Is the Corporation Managed in 2020?: The Debate over Corporate Purpose* (ECGI L., Working Paper No. 515/2020, 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3589951 [https://perma.cc/DY3C-WHHT].

185. *See* Part II.B.a. *supra*.

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