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A Legal Theory of Shareholder Primacy

Robert J. Rhee
University of Florida Levin College of Law, rhee@law.ufl.edu

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A LEGAL THEORY OF SHAREHOLDER PRIMACY

Robert J. Rhee [*]

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Abstract

Shareholder primacy is the most fundamental concept in corporate law and corporate governance. It is widely embraced in the business, legal, and academic communities. Economic analysis and policy arguments advance a normative theory that corporate managers should maximize shareholder wealth. Academic literature invariably describes shareholder primacy as a "norm." But whether the concept is "law" is contested because, remarkably, we still do not have a coherent legal theory. Our understanding of a fundamental tenet of the field is flawed and incomplete. This article presents a positive legal theory of shareholder primacy. It answers the questions: Is shareholder primacy law? What form of law is it? How does it work? The core prescription to maximize profit is misunderstood as a social norm because it cannot be in the form of an enforceable rule, the framework of a board's fiduciary duty. Such form of law would be internally incoherent with the structure of corporate law. However, to influence behavior the concept of law is not limited to a rule–sanction form. Pervasive judicial acceptance of a principle can legitimate a rule and thus impose a strong internal sense of obligation. This article conducts the first empirical study of case law discussing profit maximization for the period 1900 to 2016. It shows that shareholder primacy has become a Hartian obligation and a rule of law. The rule does not exist in a single locus duty, but instead is a filamentary principle that weaves through many other rules of corporate law and the architecture of the corporate and market systems. This article shows how the obligation, albeit unenforceable, is efficacious nonetheless.

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[*] John H. and Mary Lou Dasburg Professor of Law, University of Florida Levin College of Law. This paper was presented at a faculty colloquium at the University of Florida Levin College of Law. I thank Jonathan Cohen, Mark Fenster, Amy Mashburn, Lars Noah, William Page, and D. Daniel Sokol for their helpful comments.

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INTRODUCTION

A foundational concept of corporate law and corporate governance is the principle of shareholder primacy. It expresses the idea that shareholders have the priority interest in both economics and governance of the corporation: shareholders are said to be the principal in a principal-agent relationship on whose behalf the corporate enterprise serves.[1] Shareholder primacy instructs the board to manage the corporation solely for the purpose of maximizing shareholder wealth.

The shareholder wealth maximization norm is important because it goes to the most basic question in the field of corporate law: What is the purpose of the corporation and corporate law? The broad canvass answer—corporations are wealth-producing socioeconomic legal constructs that should profit shareholders—is without controversy. Only when we

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1 *See* Mark J. Roe, *Political Preconditions to Separating Ownership from Corporate Control*, 53 STAN. L. REV. 539, 545 (2000).

examine the question deeper does it reveal important social implications.[2] Should shareholder profit be maximize at the expense of all other interests? Are efficiency and equity irreconcilable? What about externalities and ethics? Are there social obligations within a complex democratic market system? Is shareholder profit related to social inequity? These questions do not have easy normative answers, both in the theory of the corporation and in the practice of corporate governance. The debate is as old as the dawn of the modern corporation and has persisted over many generations of economic history and academic scholarship.[3] One side of the argument answers that the sole obligation of a corporate manager is to maximize shareholder profit within the bounds of lawful activity.[4] Others disagree, arguing that shareholder profit need not always take priority over other interests or consideration.[5]

Despite persistent criticism, the idea of shareholder primacy has been

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2 The debate on corporate purpose has modern constitutional and socio-political dimensions. *See, e.g.,* Burwell v. Hobby Lobby Stores, Inc., 134 S.Ct. 2751 (2014); Citizens United v. Fed. Election Comm'n, 558 U.S. 310 (2010).

3 Compare these debates in the 1930s, 1960s, and 1990s. *See* A.A. Berle, Jr., *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049, 1049 (1931) (managers should exercise power "only for the ratable benefit of all the shareholders"); E. Merrick Dodd, Jr., *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145, 1148 (1932) (corporation "has a social service as well as a profit-making function"); MILTON FRIEDMAN, CAPITALISM AND FREEDOM 133 (1962) (there is "only one social responsibility of business—to use it resources and engage in activities designed to increase its profits"); JOHN KENNETH GALBRAITH, THE NEW INDUSTRIAL STATE 24-25 (1967) (economists and businesspersons "have abandoned, however tacitly, their commitment to maximization"); Stephen M. Bainbridge, *In Defense of Shareholder Wealth Maximization Norm: A Reply to Professor Green*, 50 WASH. & LEE L. REV. 1423, 1425 (1993) (defending shareholder primacy); Ronald M. Green, *Shareholders as Stakeholders: Changing Metaphors of Corporate Governance*, 50 WASH. & LEE L. REV. 1409, 1411 (1993) (proposing stakeholder theory).

4 *See , e.g.,* Milton Friedman, *The Social Responsibility of Business Is to Increase Its Profits*, N.Y. TIMES, Sept. 13, 1970, § 6 (Magazine), at 33; Leo E. Strine, Jr., *Our Continuing Struggle with the Idea that For-Profit Corporations Seek Profit*, 47 WAKE FOREST L. REV. 135, 155, 171 (2012) (embracing Milton Friedman's idea and arguing "corporate law requires directors, as a matter of their duty of loyalty, to pursue a good faith strategy to maximize profits for the stockholders"); *supra* note 3.

5 *See, e.g.,* William W. Bratton, *Framing a Purpose for Corporate Law*, 39 J. CORP. L. 713, 720 (2014); David Millon, *Radical Shareholder Primacy*, 10 U. ST. THOMAS L.J. 1013 (2013); LYNN STOUT, THE SHAREHOLDER VALUE MYTH: HOW PUTTING SHAREHOLDERS FIRST HARMS INVESTORS, CORPORATIONS, AND THE PUBLIC (2012); Robert J. Rhee, *Fiduciary Exemption for Public Necessity: Shareholder Profit, Public Good, and the Hobson's Choice During a National Crisis*, 17 GEO. MASON L. REV. 661, 735-36 (2010); Jill E. Fisch, *Measuring Efficiency in Corporate Law: The Role of Shareholder Primacy*, 31 J. CORP. L. 637, 638 (2006); Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733 (2005); *supra* note 3.

widely accepted.[6] However, its legal status remains uncertain even today. This is an unsatisfactory state of knowledge, all the more conspicuous since the field of corporate law has been well developed in law and scholarship. Shareholder primacy is said to be a central tenet of corporate governance. It is invariably described by corporate law scholars as a "norm," but seldom "law." Critics diminish it further to an "ideology" or "dogma."[7] Even advocates consistently describe it as a social norm.[8] Other than undue and hackneyed debate around an old Michigan case,[9] we lack a legal theory of shareholder primacy. The debate on shareholder primacy is had at the level of policy and economic rationale, advancing normative arguments for or against the idea.

This is the first article to advance a complete and coherent legal theory of shareholder primacy. It answers these basic questions: Is shareholder primacy law? If it is, how does the law work (achieve compliance)? To answer these questions, this article conducts the first empirical review of judicial discussion of shareholder profit maximization in the era of the modern corporation, the period 1900–2016. This review shows that courts have pervasively embraced the concept that corporate managers should maximize shareholder wealth.

This article posits that shareholder primacy cannot be stated as a pithy rule of law and enforceable sanction. Such a legal form would irreconcilably conflict with other foundational rules of the corporate system. A basic aspect of corporate law as we know it—the separation of ownership and control—would become incoherent. The inability to find a precise locus of law does not mean that law does not exist. Shareholder primacy is not a norm originating from a shared belief in the community, independent of legal origin or influence. It is law obligating managers to maximize value. It exists as a filament of the corporate system, weaving through various the architecture of the corporate system, its rules of law, corporate governance practices, and market mechanisms. Judicial recognition of the concept of shareholder primacy has created a Hartian obligation that is a part of

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6 *See* Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 439 (2001) ("There is no longer any serious competitor to the view that corporate law should principally strive to increase long-term shareholder value."); *infra* note 55.

7 STOUT, *supra* note 5, at 2 ("ideology"); David Millon, *Shareholder Primacy in the Classroom After the Financial Crisis*, 8 J. BUS. & TECH. L. 191, 192 (2013) ("dogma").

8 *See, e.g.*, Jonathan R. Macey, *A Close Read of an Excellent Commentary on* Dodge v. Ford, 3 VA. J. L. & BUS. REV. 177, 179 (2008); Bainbridge, *supra* note 3, at 1423.

9 Dodge v. Ford Motor Co., 170 N.W. 668 (Mich. 1919).

corporate law.[10]

This article does not advance a normative theory of shareholder wealth maximization or advance the idea that shareholder primacy promotes an equitable or responsible society. The normative arguments for and against have been well developed in legal, business, and economic scholarship. This article presents a positive legal theory explaining the structure of a complex law. The question—"what is the law?"—has not received sufficient empirical or theoretical analyses. This article contributes to the literature by presenting the first complete, coherent theory of positive law of shareholder primacy: The theory explains the reason why shareholder primacy must be in a form of law without sanctions and the precise mechanism by which the law has influenced managerial behavior toward compliance.[11] The academic, policy, and legal communities, including courts, are served by a better understanding of shareholder primacy's legal foundation and its cause and effect on the economic system.

Before starting the analysis, this article notes an important definitional distinction that is central to the theory advanced here. Although scholars sometimes use the terms *duty* and *obligation* interchangeably,[12] this article distinguishes them. Duty is defined in the doctrinal sense of a cognizable fiduciary duty subjecting directors or others to legal sanction for breach.[13] Obligation is defined in the jurisprudential sense of a government prescription that is not attached to a sanction, though it is a form of law.[14] In short, the theory of law advanced here is that while there is no duty to maximize profit, courts have imposed an obligation to do so and this prescription is efficacious even though it is unenforceable. This obligation

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10 H.L.A. HART, THE CONCEPT OF LAW (1961) (3d ed. 2012).

11 *See* Melvin A. Eisenberg, *Corporate Law and Social Norms*, 99 COLUM. L. REV. 1253, 1263 (1999) ("The process by which norms originate and are adopted as a result of changes in actors' belief-systems is extremely important generally, and is of special importance in explaining the origin and adoption of many norms that are significant in corporate law."); Robert E. Scott, *The Limits of Behavioral Theories of Law and Social Norms*, 86 VA. L. REV. 1603, 1647 (2000) ("What are the mechanisms by which law influences behavior apart from the deterrent effect of state sanctions? That question remains a fertile area for further investigation.").

12 *See, e.g.,* Leslie Green, *Law and Obligations*, in THE OXFORD HANDBOOK OF JURISPRUDENCE & PHILOSOPHY OF LAW, at 514 n.1 (eds. Jules Coleman & Scott Shapiro, 2002). Some fields of law make a clear distinction. For example, non-corporate business entity statutes distinguish duty and obligation, wherein duty refers to fiduciary duty and obligation refers to some other legal commitment. *See, e.g.*, REVISED UNIF. LIMITED LIAB. CO. ACT § 409(a),(d) (2006); UNIF. LIMITED P'SHIP ACT § 408(a),(d) (2001); REVISED UNIF. P'SHIP ACT § 404(a),(d) (1997). *See also* Gerber v. Enterprise Products Holdings, LLC, 67 A.3d 400, 418-19 (Del. 2013) (explaining the difference between fiduciary duty and the obligation of good faith and fair dealing).

13 *See infra* note 36.

14 *See infra* Section IV.B. (presenting a theory of an obligation as law).

is the law of shareholder primacy. This article unpacks how this idea works in the practice of corporate governance.

This article is organized into four sections. Section I presents the current understanding of shareholder primacy as a social norm, and it explains the core tension between shareholder primacy and managerial authority in the structure of corporate law. Section II discusses rules of law and legal aspects that partially advance the effect of shareholder primacy, including the law's treatment of inter-security conflicts, sale of corporate control, the market for corporate control, and executive pay. Section III presents empirical data from federal and states cases discussing the concept of shareholder profit maximization from 1900 to 2016. Section IV advances a complete and coherent theory of positive law, showing the mechanism by which courts and the legal system have created an obligation that, albeit unenforceable, is efficacious nonetheless.

I. THE PROBLEM OF LEGAL THEORY

Shareholder primacy is a legal enigma. It is a fundamental tenet of corporate law.[15] Yet, its legal authority seems strangely scant. In other fields of law, foundational laws are apparent in the primary sources of law. Every field has them.[16] The first statutes enacting a fundamental concept are modeled.[17] Progenitor cases are frequently cited and relied upon as authority.[18] Shareholder primacy is different. It is difficult to find the locus of law, either a well-established body of case law or a specific statute imposing a duty to comply with the command. Due to this real legal ambiguity, shareholder primacy has been debate principally on policy grounds and its legal status has been vigorously contested.

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15 *See* Grant Hayden & Matthew Bodie, *Arrow's Theorem and the Exclusive Shareholder Franchise*, 62 VAND. L. REV. 1217, 1218 n.1 (2009) ("normative foundation for modern corporate law theory"); Douglas R. Cole, *E-Proxies for Sale? Corporate Vote-Buying in the Internet Age*, 76 WASH. L. REV. 793, 831 n.192 (2001) ("central tenet of traditional corporate law").

16 *See, e.g.,* Marbury v. Madison, 5 U.S. 137 (1803); Palsgraf v. Long Island R.R. Co., 162 N.E. 99 (N.Y. 1028); Hadley v. Baxendale, 156 Eng. Rep. 145 (1854); Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837 (1984); Civil Rights Act of 1964, Pub. L. 88–352, 78 Stat. 241 (1964); Securities Act of 1933, Pub. L. 73-22, 48 Stat. 74 (1933).

17 For example, virtually every state has enacted a version of the uniform partnership laws. *See* REVISED UNIF. P'SHIP ACT (1997); UNIF. P'SHIP ACT (1914).

18 For example, *Meinhard v. Salmon*, 164 N.E. 545 (N.Y. 1928) (Cardozo, J.), stating the standard for a partner's fiduciary duty of loyalty, has been cited 1,144 time in federal and state court opinions as of November 22, 2016.

A. Whither the Law

The uncertain legal status is seen when one searches for legal authority in the traditional way that lawyers find the law: cases, statutes, and regulations stating a command, prohibition, or permission. Shareholder primacy seems to exist not as a pinpoint citation, but in the ether. It is real in that no one disputes the sense of obligation in the boardroom and executive suites, but finding the law's command is elusive. No corporation statute of the fifty states imposes a duty on the board to manage a business corporation to maximize shareholders wealth. All corporation statutes simply provide that the corporation may engage in any lawful activity.[19] In fact, a substantial number of statutes provide the opposite—that the board may consider the interests of constituents beyond shareholders.[20]

Case law imposing a duty to maximize profit is so scant that there is hackneyed over-reliance on *Dodge v. Ford Motor Co.*, a 1919 case from Michigan.[21] The case famously involved a dispute between Henry Ford and the Dodge brothers over whether the Ford Motor Company, a close corporation that Ford controlled, should pay dividends to shareholders in light of enormous accumulation of capital surplus and whether the company should be permitted to make large capital investments. Ford justified his business decisions on his philosophy that a corporation should "employ still more men, to spread the benefits of this industrial system to the greatest possible number, to help them build up their lives and their homes."[22] The Michigan Supreme Court rejected this economic philosophy and rebuked Ford: "A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end."[23]

For an old case from Michigan dealing with the legal issue of minority oppression in a close corporation, *Dodge v. Ford* has assumed an outsized

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19 *See, e.g.,* DEL. CODE ANN. tit. 8, § 101(b); MOD. BUS. CORP. ACT § 3.01(a). Most corporate charters track the statute and make no reference to profit maximization. *See, e.g.,* Restated Certificate of Incorporation of Facebook, Inc., Art. III (May 22, 2012).

20 *See* Elhauge, *supra* note 5, at 737; D. Gordon Smith, *The Shareholder Primacy Norm*, 23 J. CORP. L. 277, 279-80, 289 (1998). *See, e.g.,* FLA. STAT. § 607.0830(3); *infra* note 139 (citing cases where courts reject shareholder primacy on the basis of constituency statutes).

21 170 N.W. 668 (Mich. 1919).

22 *Id.* at 671. "The true industrial idea is not to make money. The industrial idea is to express a serviceable idea, to duplicate a useful idea, by as many thousands as there are people who need it." HENRY FORD, MY LIFE AND WORK: AN AUTOBIOGRAPHY OF HENRY FORD at 92 (1922).

23 170 N.W. at 684 (emphasis added).

prominence in legal scholarship.[24] Its celebrity is due to two factors. First, Henry Ford and the Ford Motor Company, no less the Dodge brothers, are fabled figures in American industry. Second, this history wraps a judicial statement of shareholder primacy in crystalline form. This second factor gives *Dodge v. Ford* its prominence in legal scholarship. It is a polestar. There has not been another such unconditional general embrace by a state supreme court. Despite its prominence as an iconic standard-bearer of shareholder primacy, the case has been rarely cited in the past century by other jurisdictions.[25] In Delaware, it has only been cited three times for other propositions.[26] In almost one hundred years, only the West Virginia Supreme Court has restated *Dodge v. Ford*'s iconic proposition, but in the context of justifying broad authority to engage in corporate philanthropy, a

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24 *See* STOUT, *supra* note 5, at 25 ("oversized effects of a single outdated and widely misunderstood judicial opinion"). The case has been cited in 819 law review articles, as of November 22, 2016. It is also prominent in the business law curriculum of law schools. *See, e.g.,* ROBERT J. RHEE & RUSSELL B. STEVENSON, JR., BUSINESS ORGANIZATIONS: LAW AND POLICY (9th ed. 2017 forthcoming); CHARLES R.T. O'KELLEY & ROBERT B. THOMPSON, CORPORATIONS AND OTHER BUSINESS ASSOCIATIONS: CASES AND MATERIALS 270-73 (7th ed. 2014); M. Todd Henderson, *The Story of Dodge v. Ford: Everything Old Is New Again*, in CORPORATE LAW STORIES at 37-75 (Mark J. Ramseyer, ed., 2009).

25 The case is cited in 42 state court opinions as of November 22, 2016. Compare this to the 1,144 citations to *Meinhard v. Salmon*, *supra* note 18. Of the 23 non-Michigan cases, most cite the case for the proposition related to rebutting the business judgment rule to compel dividends. Blackwell v. Nixon, 1991 WL 194725, at *4 (Del.Ch. 1991); Alaska Plastics, Inc. v. Coppock, 621 P.2d 270, 277 (Alaska 1980); Donahue v. Rodd Electrotype Co. of New England, Inc., 328 N.E.2d 505, 514 (Mass. 1975); Hall v. John S. Isaacs & Sons Farms, Inc., 163 A.2d 288, 295 (Del. 1960); Gordon v. Elliman, 119 N.E.2d 331, 334 (N.Y. 1954); Meadows v. Bradshaw-Diehl Co., 81 S.E.2d 63, 69 (W.Va. 1954); Swinton v. W.J. Bush & Co., 102 N.Y.S.2d 994, 997 (Sup.Ct. 1951); Ostlind v. Ostlind Valve, 165 P.2d 779, 789 (Ore. 1946); Johnson v. Lamprecht, 15 N.E.2d 127, 131 (Ohio 1938); Dodge v. Scripps, 37 P.2d 896, 902 (Wash. 1934); City Bank Farmers' Trust Co. v. Hewitt Realty Co., 177 N.E. 309, 311 (N.Y. 1931); Jones v. Van Heusen Charles Co., 246 N.Y.S. 204, 208-09 (App.Div. 1930); Farmers' Loan & Trust Co. v. Pierson, 222 N.Y.S. 532, 537 (Sup.Ct. 1927); Gesell v. Tomahawk Land Co., 200 N.W. 550, 556 (Wisc. 1924). Several courts have cited *Dodge v. Ford* for the proposition related to minority oppression by a majority shareholder, or a general statement of law regarding bad faith, fraud, or breach of fiduciary duty by a manager. Hill v. State Farm Mut. Auto. Ins. Co., 83 Cal.Rptr.3d 651, 692 (App. 2008); Zidell v. Zidell, Inc., 560 P.2d 1086, 1089 (Ore. 1977); Shlensky v. Wrigley, 237 N.E.2d 776, 779-80 (Ill.App. 1968); Long v. Norwood Hills Corp., 380 S.W.2d 451, 476 (Mo.App. 1964); Rogan v. Oliver, 110 So.3d 980, 983 (Fla.App.Ct. 2013). Two cases cite *Dodge v. Ford* for propositions related to corporate philanthropy. A.P. Smith Mfg. Co. v. Barlow, 98 A.2d 581, 584 (N.J. 1953); E. I. Du Pont De Nemours & Co. v. Clark, 88 A.2d 436, 444 (Del. 1952) (Tunnell, J., dissenting).

26 *See supra* note 25.

concept that is at least in tension with maximizing shareholder profit.[27]

There is another anomalous case. In *eBay Domestic Holdings, Inc. v. Newmark*, the founders of Craigslist, a website created for users to list products and services for sale, adopted a poison pill plan to thwart eBay's attempt to acquire Craigslist.[28] Delaware has long legitimized the use of poison pills,[29] as long as the defensive measure is a reasonable response to the threat posed to the corporation under *Unocal*.[30] The founders of Craigslist argued that the poison pill was necessary to protect Craigslist's social values and community-centric corporate culture, which would be threatened by the acquisition of the corporate giant eBay.[31] The Delaware Chancery Court rejected the argument and its reasoning echoed the *Dodge v. Ford* proclamation:

> Jim and Craig did prove that they personally believe craigslist should not be about the business of stockholder wealth maximization, now or in the future. . . . Having chosen a for-profit corporate form, the craigslist directors are bound by the fiduciary duties and standards that accompany that form. Those standards include acting to promote the value of the corporation for the benefit of its stockholders. The "Inc." after the company name has to mean at least that. Thus, I cannot accept as valid for the purposes of implementing the Rights Plan a corporate policy that specifically, clearly, and admittedly seeks *not* to maximize the economic value of a for-profit Delaware corporation for the benefit of its stockholders . . . . 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.[32]

This statement strongly embraces shareholder primacy. It is a trial court opinion of a single judge, but still an influential court. If *Dodge v. Ford* is a polestar, *eBay Domestic Holdings, Inc. v. Newmark* is a sign of the season, a trade wind blowing toward shareholder-centrism.

The point still stands: case law is scant. In the over one hundred years of the modern era of corporations and in light of a well-developed corporate law, there does not seem to be a weight of case law establishing a duty on

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27 *See* Gilbert v. Northfolk & W. Ry. Co., 171 S.E. 814, 815 (W.Va. 1933).

28 16 A.3d 1, 15-16 (Del.Ch. 2010) (Chandler, C.).

29 Moran v. Household Int'l, Inc., 500 A.2d 1346 (Del. 1985).

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

31 16 A.3d at 32.

32 *Id.* at 34-35 (emphasis in original).

boards to maximize shareholder profit in managing a going concern. In this respect, these cases could just as well be characterized as outlier opinions rather than crystalline examples of existing principle. In light of the disconnection between *Dodge v. Ford*'s prominence and its actual influence on corporate law, some commentators have dismissed the case as largely irrelevant.[33]

B. *Conflict with Managerial Authority*

Unlike other business entities, corporate law presupposes a manager in the form of a board and vests the board with managerial authority.[34] A duty to maximize profit, subjecting the board's decision to judicial review, would impose a framework of a rule and enforceable sanction (hereinafter "rule–sanction"). In the study of jurisprudence, such a law is said to be Austinian in the sense of an order backed by the threat of government power.[35] It is blackletter law that fiduciary duties in corporate law are liability rules; the breach of the duties of care and loyalty may result in legal liability for various parties subject to the liability scheme.[36] The basic tenets of corporate law are the separation of ownership and control[37] and the primacy of managerial authority.[38] As a conceptual matter, a rule–sanction framework of a duty to maximize profit presents an irreconcilable conflict between

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33 Millon, *supra* note 5, at 1023; STOUT, *supra* note 5, at 25-29; Lynn A. Stout, *Why We Should Stop Teaching Dodge v. Ford*, 3 VA. L. & BUS. REV. 163, 168-74 (2008). *See* Smith, *supra* note 20, at 322 (arguing that due to the business judgment rule "the shareholder primacy norm is nearly irrelevant"). *But see* Bernard S. Sharfman, *The Importance of the Business Judgment Rule*, *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2888052 (arguing that the policy behind the business judgment rule is grounded in shareholder wealth maximization).

34 *See, e.g.,* DEL. CODE ANN. tit. 8, § 141(a); MOD. BUS. CORP. ACT. § 8.01(a).

35 *See* HART, *supra* note 10, at 16-17 (discussing Austin's concept of law in JOHN AUSTIN, THE PROVINCE OF JURISPRUDENCE DETERMINED (1832)).

36 *See, e.g.,* RBC Capital Markets, LLC v. Jervis, 129 A.3d 816 (Del. 2015); In re Rural Metro Corp., 88 A.3d 54, 110 (Del.Ch. 2014); Gantler v. Stephens, 965 A.2d 695 (Del. 2011); Cede & Co. v. Technicolor, Inc., 634 A.2d 345 (Del. 1993); Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985); Weinberger v. UOP, Inc., 457 A.2d 701 (Del. 1983); Guth v. Loft, 5 A2d 503 (Del. 1939).

37 N. Am. Catholic Educ. Prog. Foundation, Inc. v. Gheewalla, 930 A.2d 92, 101 (Del. 2007); Malone v. Brincat, 722, A.2d 5, 9 (Del. 1998); Randy J. Holland, *Delaware's Business Courts: Litigation Leadership*, 34 J. CORP. L. 771, 779 (2009).

38 DEL. CODE ANN. tit. 8, § 141(a); MOD. BUS. CORP. ACT. § 8.01(a); Paramount Communications, Inc. v. Time Inc., 571 A.2d 1140, 1154 (Del. 1990); Aronson v. Lewis, 473 A.2d 805, 811 (Del. 1984).

authority and accountability because profit-seeking is the core managerial function in a business corporation.[39]

Shareholder primacy is clearly unenforceable on its own term because the business judgment rule would defeat any claims based on a failure to maximize profit.[40] Corporate managers formulate business strategy. A rule–sanction is antithetical to the core concept of the business judgment rule. In over one hundred years of modern corporate law, has a state supreme court imposed liability for breach of fiduciary duty on the specific ground that the board, in managing operational matters, failed to maximize shareholder profit, though it made the decision informedly, disinterestedly, and in good faith?[41] That case does not exist. In fact, many cases show just the opposite. Courts have held that shareholders cannot challenge a board's decision on the specific grounds that, for example: the company paid its employees too much;[42] it failed to pursue a profit opportunity;[43] it did not maximize the settlement amount in a negotiation;[44] it failed to lawfully avoid taxes.[45] There are classic textbook cases where courts have rejected attempts of shareholders to interfere with the board's decisions on the argument that their views of business or strategy would have maximized

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39 *See* Bainbridge, *supra* note 38, at 604-05 (noting the conflict between authority of managers and accountability to shareholders); Michael P. Dooley & E. Norman Veasey, *The Role of the Board in Derivative Litigation: Delaware Law and the Current ALI Proposals Compared*, 44 BUS. LAW. 503, 522 (1989) ("The power to hold to account is the power to interfere and, ultimately, the power to decide."). *See also* MM Companies, Inc. v. Liquid Audio, Inc., 813 A.2d 1118, 1126 (Del. 2003) ("The most fundamental principles of corporate governance are a function of the allocation of power within a corporation between its stockholders and its board of directors.").

40 STOUT, *supra* note 5, at 29; Macey, *supra* note 8, at 180-81; Smith, *supra* note 20, at 286; D. Gordon Smith, *Response: The Dystopian Potential of Corporate Law*, 57 EMORY L.J. 985, 1002 (2008). *See* Bratton, *supra* note 5, at 716 ("A legal mandate to maximize makes no sense in a dynamic economy.").

41 *See* Fisch, *supra* note 5, at 651 ("Although *Dodge v. Ford* is frequently cited, no modern court has struck down an operational decision on the ground that it favors stakeholder interests over shareholder interests.").

42 *See, e.g.,* In re The Goldman Sachs Group, Inc. S'holder Litig., 2011 WL 4826104 (Del.Ch. 2014); In re Walt Disney Co. Derivative Litigation, 906 A.2d 27 (Del. 2006).

43 *See, e.g.,* Shlensky v. Wrigley, 237 N.E.2d 776 (Ill.App. 1968).

44 *See, e.g.,* Carlton Investments v. TLC Beatrice Int'l Holdings, Inc., 1997 WL 305829 (Del.Ch. 1997).

45 *See, e.g.,* Kamin v. American Express Co., 387 N.Y.S.2d 993 (App.Div. 1976). Taxpayers have a right to pursue lawful tax avoidance strategies. Gregory v. Helvering, 293 U.S. 465, 469 (1935). Yet, there is no duty under corporate law to lawfully avoid tax. *See* Freedman v. Adams, 2012 WL 1345638, at *13 (Del.Ch. 2012); Seinfeld v. Slager, 2012 WL 2501105, at *3 (Del.Ch. 2012).

shareholder value.[46]

A rule–sanction would be difficult and inefficient to implement through a liability rule. Commanding a board to maximize profit upon threat of sanction does not shed light on how it should do so. Such a command is different from instructing a person not to drive negligently. Profit is a score, not a strategy. An indeterminate set of potential business strategies, each subject to unique business risk, must be reviewed and second-guessed through the litigation system.[47] In concrete terms, there may be no way to tell how profits can be maximized for the New York Times as between two strategies: firing a number of reporters and thereby cutting employee costs, or hiring more and thereby increasing costs. The former could be characterized as a financial strategy based on the company's margin structure; the latter could be a strategy based on producing the highest quality product. A specific corporate action may be motivated by profit maximization, but it is not a deterministic end of such motive. The profit motive may result in stochastic corporate actions.[48]

If there is an enforceable duty, courts will struggle over the proper allocation of authority and accountability for business actions and profits. Any new division between deference and judicial review would require some judicial determination of whether profit has been maximized. Foundational rules of corporate law, such as the separation of ownership and control and the business judgment rule, would be tested in a conceptual shift. This conflict would ultimately be inefficient and incoherent.

Neither *Dodge v. Ford* nor *eBay Domestic Holdings, Inc. v. Newmark* conflicts with this analysis. In both cases, the specific holdings did not rest on or establishes an independent fiduciary duty to maximize profit, enforceable by sanctions. The holding in *Dodge* rested on an abuse of discretion in Ford's dividend decision in the context of a minority freeze

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[46] *See, e.g.,* Kamin v. American Express Co., 387 N.Y.S.2d 993 (App.Div. 1976); Shlensky v. Wrigley, 237 N.E.2d 776 (Ill.App. 1968).

[47] *See* E. Norman Veasey, *Should Corporate Law Inform Aspirations for Good Corporate Governance Practice—or Vice Versa?*, 149 U. PA. L. REV. 2179, 2184-85 (2001); In re Pure Resources, Inc. Shareholders Litigation. 808 A.2d 421, 434-35 (Del.Ch. 2002).

[48] *See* Michael C. Jensen, *Value Maximization, Stakeholder Theory, and the Corporate Objective Function*, 12 BUS. ETHICS Q. 235, 245 (2002) ("[V]alue maximizing says nothing about how to create a superior vision or strategy."); Roe, *supra* note 52, at 2072 (noting that corporate law's instructions to managers to enhance shareholder profit do not "determine what they do").

out.[49] The holding in *eBay* rested on the court's application of the *Unocal* enhanced standard of review applicable to corporate defensive measures.[50] As a doctrinal matter, neither case can fairly be read to establish a cognizable duty to maximize profit, though clearly the admitted failure to maximize profit by the controlling shareholders in both cases was a significant, if not dispositive, factor in the holdings that rested on other doctrines of corporate law.

C. Academic Discourse and Consensus

In light of the seemingly scant law and the doctrinal problem of a rule–sanction framework, academic discourse on shareholder primacy has revolved around theoretical and policy arguments (after the usually obligatory discussion of *Dodge v. Ford*).[51] Legal scholarship almost always describes shareholder primacy as a social norm.[52] This descriptive is significant because a norm is generally not considered law and is not subject to legal sanction.[53] The unclear legal status of shareholder primacy is evident in academic discourse.

In an influential essay, Henry Hansmann and Reinier Kraakman argue that as an observed matter corporate law has reached an ultimate consensus: "The point is simply that now, as a consequence of both logic and experience, there is convergence on a consensus that the best means to this end (that is, the pursuit of aggregate social welfare) is to make corporate managers strongly accountable to shareholder interests and, at least in

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49 170 N.W. 668, 682-85 (Mich. 1919). Several scholars have correctly noted that the holding relates specifically to minority oppression by withholding dividends. Smith, *supra* note 20, at 315; STOUT, *supra* note 5, at 26-27.

50 16 A.3d 1, 28-35 (Del.Ch. 2010).

51 The rise of shareholder primacy as an idea has been well described in legal scholarship. *See* STOUT, *supra* note 5, at 18-19; Millon, *supra* note 7, at 1025-34; Fisch, *supra* note 5, at 656-61. In brief, shareholder primacy arose from theoretical work by economists in the 1970s and 1980s, resulting in subsequent law and economic conception of corporate law. *See, e.g.*, Eugene Fama, *Agency Problems and the Theory of the Firm*, 88 J. POL. ECON. 288 (1980); Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs, and Capital Structure*, 3 J. FIN. ECON. 305 (1976); FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 38 (1996).

52 A Westlaw search of the terms "shareholder primacy norm" and "shareholder wealth maximization norm" shows that a total of 618 articles used one of the two terms as of November 22, 2016. *See, e.g.*, James D. Nelson, *The Freedom of Business Association*, 115 COLUM. L. REV. 461, 502 (2015); Bratton, *supra* note 5, at 720; Fisch, *supra* note 5, at 637; Bainbridge, *supra* note 38, at 573; Hansmann & Kraakman, *supra* note 6, 465-66 n.41; Mark J. Roe, *The Shareholder Wealth Maximization Norm and Industrial Organization*, 149 U. PENN. L. REV. 2063, 2064 (2001); Smith, *supra* note 20, at 277.

53 *See infra* notes 190-192 and accompanying text.

direct terms, only to those interests."[54] This "standard" model reflects an internalization of shareholder-centric ideology by a broad consensus of business, government, and legal elites.[55] Absent in the analysis was discussion of law and its relationship to observed internalization of shareholder primacy.[56]

In an article specifically analyzing *Dodge v. Ford*, Jonathan Macey argues that the case has "legal effect" and is a "positive account of what corporate law actually is,"[57] but has also noted the limited evidence of law in the form of a rule–sanction. He explains that the reason we rarely see case like *Dodge v. Ford* is because managers are better coached and are more willing to dissemble than Ford was to get the benefit the business judgment deference.[58] Shareholder primacy is "the law on the books, if not in practice."[59] The concept is like a street sign that clearly posts a speed limit, but the actual norm is to drive faster than the posted sign. The problem is not the lack of clarity of the rule, but the lack of enforceability of the rule.[60] Shareholder primacy is unenforceable because managers can hide behind the business judgment rule as long as they do not reveal their motive as Ford had done.[61] Thus, on the one hand profit maximization "actually is" corporate law, but at the same time Macy calls it a "norm."[62]

In a recent essay, Leo Strine, the chief justice of the Delaware Supreme Court, defends shareholder primacy from a normative perspective.[63] This essay is notable in two respects. First, invoking Milton Friedman's famous

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54 Hansmann & Kraakman, note 6, at 441.

55 *Id.* at 439. *See* Nelson, *supra* note 52, at 501-02 ("widely accepted social norm among business leaders"); STOUT, *supra* note 5, at 4 ("accepted as a truth" by business and policy elites); Stephen M. Bainbridge, *Director Primacy in Corporate Takeovers: Preliminary Reflections*, 55 STAN. L. REV. 791, 798 & n.35 (2002) ("most corporate law scholars embrace some variant of shareholder primacy"); Smith, *supra* note 20, at 278 (fully internalized by managers); Fisch, *supra* note 5, at 640 ("overwhelmingly embraced" by scholars). *See also* Edwards v. Morrow, 725 S.E.2d 366 (N.C.App. 2012) ("From an economics standpoint, it is considered a given that the primary aim of a for-profit entity is profit maximization.").

56 The article cited no primary legal authority, except a minor citation to *Weinberger v. UOP, Inc.*, 457 A.2d 701 (Del. 1983). *Id.* at 456 n.28.

57 Macey, *supra* note 8, at 178, 180.

58 *Id.* at 180.

59 *Id.* at 181.

60 *Id.*

61 *See supra* notes 33, 40 & 41.

62 *Id.* at 179. *See* George A. Mocsary, *Freedom of Corporate Purpose*, 2016 B.Y.U. L. REV. 1319, 1342 (calling it both "law" and "norm").

63 Strine, *supra* note 4.

manifesto on profit maximization,[64] Strine states that "corporate law requires directors, as a matter of their duty of loyalty, to pursue a good faith strategy to maximize profits for the stockholders."[65] Linking shareholder wealth maximization to the duty of loyalty is a serious matter in the practice of corporate law because money damages against a director for a breach cannot be exculpated.[66] With that said, Strine caveats his statement by reciting the primacy of managerial authority: "The directors, of course, retain substantial discretion, outside the context of a change of control, to decide how best to achieve that goal and the appropriate time frame for delivering those returns."[67] This comment acknowledges the incoherence of subjecting managerial authority to a rule–sanction for the failure to maximize profit.[68] Second, like Hansmann and Kraakman's earlier essay, Strine's essay is notable in that he does not make a sustained legal argument for shareholder primacy. He cites and discusses *Dodge v. Ford* and *eBay v. Newmark*, but this discussion punctuates a largely policy-laden argument supported by academic literature on shareholder primacy.[69]

Lastly, the contestability of the legal status of shareholder primacy is evident in a recent New York Time opinion editorial debate between Lynn Stout and Stephen Bainbridge, two eminent scholars of corporate law. Stout argues that corporate law does not mandate a legal duty to maximize profit.[70] But Bainbridge argues that shareholder primacy has been the law since *Dodge v. Ford*.[71] On the basic question of defining the law, their positions at first glance seem contradictory.

The above review of literature is not a criticism, but simply confirms the earlier observation that pinpointing the law of shareholder primacy has been elusive. Without a positive legal theory, the academic discourse does not rely on the law so much as it defaults to normative arguments to suggest

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64 *See supra* note 4.

65 Strine, *supra* note 4, at 155, 171. Strine further echoes Milton Friedman when he suggests that profit maximization promotes "the public interest." *Id.* at 135-36.

66 DEL. CODE ANN. tit. 8, § 102(b)(7).

67 Strine, *supra* note 4, at 155.

68 Delaware jurists have suggested that shareholder primacy is "a matter of principle," but stopped short of calling it law. William T. Allen, Jack B. Jacobs & Leo E. Strine, Jr., *The Great Takeover Debate: A Meditation on Bridging the Conceptual Divide*, 69 U. CHI. L. REV. 1067, 1079 (2002).

69 *See* Strine, *supra* note 4, at 145-55.

70 Lynn Stout writes: "There is a common belief that corporate directors have a legal duty to maximize corporate profits and 'shareholder value'—even if this means skirting ethical rules, damaging the environment or harming employees. But this belief is utterly false." Lynn Stout, *Corporations Don't Have to Maximize Profits*, N.Y. TIMES (Apr. 16, 2015).

71 Stephen Bainbridge writes: "Despite contrary claims by some academics and Occupy Wall Street-type partisans, this [*Dodge v. Ford Motor Co.*] remains the law today." Stephen Bainbridge, *A Duty to Shareholder Value*, N.Y. TIMES (Apr. 16, 2015).

what law or corporate governance norm is or should be. The implicit assumption is that the suasion of normative theory, manifesting in a social norm, is the root cause of managerial internalization and behavior.

Even today, the legal status of a fundamental concept of corporate law is uncertain and contestable. The legal theory advanced in this article show that both Stout and Bainbridge, and other commentators, are correct in their precise positions: shareholder primacy is not a duty, but it is law; it is broadly obeyed and thus efficacious, but it is unenforceable. Advocates and critics of shareholder primacy are not as far apart as they seem to be. The apparent conflict in their positions is grounded in two factors: first, an incompleteness of the concept of law resulting in an implicit assumption that the law must take the form of an independent fiduciary duty; second, an underappreciation of the role of courts in recognizing and advancing a legal obligation. A coherent legal theory can bridge the apparent divide in conflicting positions and our understanding of the most important rule of corporation law as it has come to be developed by courts.

II. Partial Shareholder Primacy

Shareholder primacy does not exist as a single locus rule–sanction, but instead weaves through a series of rules of corporate law and the architecture of the corporate and market systems. Corporate law *partially* achieves the end of shareholder primacy through three discrete pathways. First, in realm of corporate finance, when there is an inter-security conflict of interest among capital providers involving common stock, corporate law mandates that the value of common stock must be maximized over other securities. Second, in the realm of takeovers, corporate law imposes a duty to maximize common stock value when the corporation is selling control. Third, in the vast realm of day-to-day managerial decisionmaking in a going concern, there is not a single locus, easily identifiable rule of law that mandates profit maximization, but the corporate and market systems, constructed through the legal system, steer managers toward the end of shareholder primacy even when corporate law empowers the primacy of managerial authority.

A. Inter-Security Priority

Shareholder primacy is clearly evident in the realm of corporate finance. Among securityholders, common stockholders are owed fiduciary duty and are preferred over other securityholders. Although the variety of securities a corporation can issue is limited only by the freedom of contract, there are three principal classes of securities: debt, preferred stock, and common stock. These financial instruments often present inter-security conflicts among securityholders.

Consider the relative positions of creditors and common stockholders. The interests of creditors and shareholders can conflict because managers, in the pursuit of shareholder wealth, can make decisions that externalize risk to creditors, a form of opportunism that enriches shareholders at the cost of creditors.[72] Although corporate law provides some protection to creditors,[73] the creditor's principal protection is the ability to negotiate for the terms of credit through contract law.[74] Outside of insolvency, creditors are not owed fiduciary duty,[75] but of course common stockholders are.[76] This makes economic sense since creditors have priority rights to corporate income and assets and thus take less financial risk than common stockholders.[77]

The primacy of shareholders over creditors is seen in several doctrines. Creditors invoke the doctrine of the implied covenant of good faith and fair dealing when the issuer corporation takes an action that benefits shareholders at their expense and there are no express contractual protections in the credit contract. Courts have limited the application of this contract doctrine, essentially rejecting an independent cause of action for bad faith action against creditors. Absent an identifiable connection to a bargained for term in the contract, courts generally reject these claims.[78]

A more direct example illustrating the primacy of common stock over

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

73 *See* DEL. CODE ANN. tit. 8, § 160(a); MOD. BUS. CORP. ACT § 6.40(j); Klang v Smith's Food & Drug Centers, Inc. 702 A.2d 150 (Del. 1997).

74 AMERICAN BAR FOUNDATION, COMMENTARIES ON INDENTURES at 2 (1971); Mann v. Oppenheimer & Co., 517 A.2d 1056, 1061 (Del. 1986); Production Res. Group v. NCT Group, Inc., 863 A.2d 772, 790 (Del.Ch. 2004).

75 N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla 930 A.2d 92, 99, 101-02 (Del. 2007); Simons v. Cogan, 549 A.2d 300, 304 (Del. 1988); Katz v. Oak Indus., Inc., 508 A.2d 873, 879 (Del.Ch. 1986). *See* Simons v. Cogan, 549 A.2d 300, 303 (Del. 1988) (no duty to convertible bondholders).

76 Malone v. Brincat, 722 A.2d 5, 9 (Del. 1998).

77 *See* RICHARD BREALEY, STEWART MYERS & FRANKLIN ALLEN, THE PRINCIPLES OF CORPORATE FINANCE 493 n.12 (11th ed. 2013).

78 *See, e.g.,* Metropolitan Life Insurance Co. v. RJR Nabisco, Inc., 716 F.Supp. 1504, 1520 (S.D.N.Y. 1989) ("The sort of unbounded and one-sided elasticity urged by plaintiffs would interfere with and destabilize the market."); Winshall v. Viacom Intern., Inc., 76 A.3d 808, 816 (Del. 2013) ("Rather, a party may only invoke the protections of the covenant when it is clear from the underlying contract that the contracting parties would have agreed to proscribe the act later complained of . . . had they thought to negotiate with respect to that matter.").

debt is seen in a seminal Delaware case on coercion and exit consents. In *Katz v. Oak Industries Inc.*, bondholders objected to a coercive exchange offer that was conditioned on the tendering bondholders providing the company exit consents to amend the indenture.[79] The corporation extended the exchange offer as a part of a restructuring, which required removing protections that hindered the restructuring. The complaining bondholders argued that the exchange offer was coercive and that the amendment was designed to strip nontendering bondholders of their protective covenants. They averred that "the purpose and effect of the Exchange Offers is to benefit Oak's common stockholders at the expense of the Holders of its debt."[80] The court held that the exchange offer was in fact coercive, but not wrongfully so.[81]

> *It is the obligation of directors to attempt, within the law, to maximize the long-run interests of the corporation's stockholders*; that they may sometimes do so "at the expense" of others (even assuming that a transaction which one may refuse to enter into can meaningfully be said to be at his expense) does not for that reason constitute a breach of duty. *It seems likely that corporate restructurings designed to maximize shareholder values may in some instances have the effect of requiring bondholders to bear greater risk of loss and thus in effect transfer economic value from bondholders to stockholders*.[82]

The issuing corporation must respect the legal duties to creditors under contract law, but otherwise the board has a duty to prefer the interest of shareholders over creditors. When a board benefits common stockholders through the intentional infliction of economic loss on creditors (*e.g.*, through risk shifting in *Katz*), absent an impairment of capital or fraudulent conveyance, the board and the corporation act pursuant to the duty to shareholders.

Consider next the relative positions among preferred stockholders and common stockholders. The priority of interest is more nuanced since both are stockholders, but ultimately Delaware law has evolved to prefer clearly the interest of common stockholders over that of preferred stockholders.

At common law, unless preferences are found in the certificate of

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79 508 A.2d 873 (Del. Ch. 1986).

80 *Id.* at 879.

81 *Id.* at 880-82.

82 *Id.* at 879 (emphasis added).

incorporation, all shares of stock are equal and thus court do not recognize a preference in forms of stock.[83] Contractual preferences provide preferred stockholders benefits and also limitations. The typical preferences are priorities over dividend and liquidation and a limitation on participation beyond the fixed dividend.[84] When the right asserted is not a preference, fiduciary duties are owed to preferred stockholders as well.[85] Delaware cases followed this common law rule.[86] However, Delaware has steadily undermined the rule of equality.

In the 1990s, Delaware law evolved in favor of common stockholders. Rather than viewing preferred stock as a form of stock with contractually negotiated preferences but otherwise standing in equal dignity to common stock, Delaware courts emphasized the contractual nature of preferred stock, thus treating preferred stock more like debt than common stock.[87]

In *Equity-Linked Investors, L.P. v. Adams*, preferred stockholders (early venture capital investors in a struggling public company) desired to liquidate the company and common stockholders sought to continue the enterprise by seeking new capital funding.[88] In light of Delaware's evident policy preference in favor of business decisions promoting the continuation of a going concern,[89] the court's ruling in favor of common stockholders is not so remarkable. However, the justification for its ruling is revealing:

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83 Jedwab v. MGM Grand Hotels, Inc., 509 A.2d 584, 593-94 (Del.Ch. 1986); Shanghai Power Co. v. Delaware Trust Co., 316 A.2d 589, 593 (Del.Ch. 1974), *aff'd in part, rev'd in part by* Judah v. Delaware Trust Co., 378 A.2d 624 (Del. 1977). *See* MCG Capital Corp. v. Maginn, 2010 WL 1782271, at *6 (Del.Ch. 2010) ("I begin with the proposition that all stock is created equal. By this I mean that all classes of stock enjoy the same rights and privileges unless an affirmative expression alters those rights.").

84 ROBERT J. RHEE, CORPORATE FINANCE at 312-13 (2016).

85 *See* Jedwab v. MGM Grand Hotels, Inc., 509 A.2d 584, 594 (Del.Ch. 1986) (stating that where there is no stated preference "the existence of such right and the scope of the correlative duty may be measured by equitable as well as legal standards"). *See also* MCG Capital Corp. v. Maginn, 2010 WL 1782271, at *6 (Del.Ch. 2010) (holding that preferred stockholders have standing to bring derivative actions).

86 *See, e.g.,* Orban v. Field, 1997 WL 153831 (Del.Ch. 1997); In re FLS Holdings Inc. S'holder Litig., 1993 WL 104562 (Del.Ch. 1993); Eisenberg v. Chicago Milwaukee Corp., 537 A.2d 1051 (Del.Ch. 1987); Jedwab v. MGM Grand Hotels, Inc., 509 A.2d 584 (Del.Ch. 1986); Dalton v. American Inv. Co., 490 A.2d 574 (Del.Ch. 1985).

87 Preferred stock is a hybrid instrument that has the features of both debt and equity. *See* RHEE, *supra* note 84, at 311-12. *See generally* Richard M. Buxbaum, *Preferred Stock—Law and Draftsmanship*, 42 CAL. L. REV. 243 (1954).

88 705 A.2d 1040 (Del.Ch. 1997).

89 *See, e.g.,* Orban v. Field, 1997 WL 153831 (Del.Ch. 1997); Credit Lyonnais Bank Nederland, N.V. v. Pathe Communications Corp., 1991 WL 277613 (Del.Ch. 1991); Katz v. Oak Indus., Inc., 508 A.2d 873, 879 (Del.Ch. 1986).

> While the facts out of which this dispute arises indisputably entail the imposition by the board of (or continuation of) economic risks upon the preferred stock which the holders of the preferred did not want, and while this board action was taken for the benefit largely of the common stock, those facts do not constitute a breach of duty. . . . The special protections offered to the preferred are contractual in nature. The corporation is, of course, required to respect those legal rights. But, aside from the insolvency point just alluded to, generally *it will be the duty of the board, where discretionary judgment is to be exercised, to prefer the interests of common stock . . . to the interests . . . of preferred stock, where there is a conflict*. *See Katz v. Oak Industries, Inc*.[90]

This passage departs from the traditional understanding under common law that, if a preference is not stated, stocks are considered equal.[91] Under *Equity-Linked Investors*, absent a special preference in the corporate contract, the interest of common stockholders may be elevated over the interest of preferred stockholders. Furthermore, by citing *Katz v. Oak Industries* as authority and analogizing the permissibility of transferring risk from common stockholders to other securityholders, the court pushes the analysis of preferred stock toward the same analytical framework applicable to credit contracts.

Several recent cases in Delaware have further strengthened the hand of common stockholders. In *In re Trados Inc. Shareholder Litigation*, the board pursued a merger in which virtually all of the merger consideration would go the preferred stockholders due to the triggering of a liquidation preference.[92] Common stockholders got nothing. A common stockholder averred in the complaint that the board, comprised mostly of directors elected by preferred stockholders, breached its fiduciary duty to them. The court noted: "in circumstances where the interests of the common stockholders diverge from those of the preferred stockholders, it is *possible* that a director could breach her duty by improperly favoring the interests of the preferred stockholders over those of the common stockholders."[93] The court set forth a principle that, unless a preference is expressly

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90 Equity-Linked, 705 A.2d at 1042 (emphasis added).

91 "At common law and in the absence of an agreement to the contrary all shares of stock are equal. . . . [W]here however the right asserted is not to a preference as against the common stock but rather a right shared equally with the common, the existence of such right and the scope of the correlative duty may be measured by equitable as well as legal standards." Jedwab v. MGM Grand Hotels, Inc., 509 A.2d 584, 593-94 (Del.Ch. 1986).

92 2009 WL 2225958 (Del.Ch. 2009).

93 *Id*. at *7.

provided in the corporate contract, where the interests of preferred and common stockholders conflict the latter's interest is preferred.[94] This proposition—stated in both *Equity-Linked* and *Trados*—turns the original rule in common law upside down, because under traditional common law all stocks are treated equally unless there is a stated preference right or limitation therefrom.

In *LC Capital Master Fund, Ltd. v. James*, the issue again involved the allocation of merger consideration between convertible preferred and common stockholders.[95] The certificate did not set a contractual merger price to be paid to the preferred stockholders. The preferred stockholders argued that the fair allocation should exceed the "as converted" value of their stock due to the unique features of the stock and the circumstance of the preferred stockholders.[96] The court rejected this argument, reasoning that the contractual right of conversion determines the duty owed by the board to the preferred stockholders. In this case, the board "was entitled to favor the interests of the common stockholders."[97] The court acknowledged that recent decisions discussing fiduciary duties to preferred stockholders conflict with earlier cases.[98] The court attempted to harmonize the conflict. When the rights of the preferred are found in the contract, the board must

94 In subsequent proceeding, the chancery court ultimately held that, under the entire fairness standard, the merger consideration to the common stockholder was fair. In re Trados Shareholder Litigation, 73 A.3d 17 (Del.Ch. 2013). The court emphasized in the analysis:

> To reiterate, the standard of conduct for directors requires that they strive in good faith and on an informed basis to maximize the value of the corporation for the benefit of its residual claimants, the ultimate beneficiaries of the firm's value, not for the benefit of its contractual claimants. In light of this obligation, "it is the duty of directors to pursue the best interests of the corporation and its common stockholders, if that can be done faithfully with the contractual promises owed to the preferred."

Id. at 41-42 (quoting LC Capital Master Fund, Ltd. v. James, 990 A.2d 435, 452 (Del.Ch. 2010)).

95 990 A.2d 435 (Del.Ch. 2010).

96 Previously, Delaware courts have considered the unique features of the preferred stock and the circumstance of their holders when considering the fairness of the merger consideration. *See, e.g.,* Jedwab v. MGM Grand Hotels, Inc., 509 A.2d 584 (Del.Ch. 1986); In re FLS Holdings Inc. S'holder Litig., 1993 WL 104562 (Del.Ch. 1993).

97 LC Capital, 990 A.2d at 438.

98 *Id.* at 446-47 (citing apparent tension in recent cases such as *In re Trados Inc. S'holder Litig.*, 2009 WL 2225958 (Del.Ch. 2009), with older cases such as *Jedwab v. MGM Grand Hotels, Inc.*, 509 A.2d 584 (Del.Ch. 1986) and *In re FLS Holdings Inc. S'holder Litig.*, 1993 WL 104562 (Del.Ch. 1993)).

honor them, but it does not owe any further "unspecified fiduciary beneficence on the preferred at the expense of the common."[99] When, however, there is no contractual basis for treatment of the preferred, the board must engage in gap-filling and attempt to fairly reconcile the competing interests of the common and preferred. Echoing *Equity-Linked* and *Trados*, the court endorsed the rule "that it is the duty of directors to pursue the best interests of the corporation and its common stockholders, if that can be done faithfully with the contractual promises owed to the preferred."[100]

In an insightful article, William Bratton and Michael Wachter observe that preferred stock is subject to the tug and pull of conflicting analytical paradigms of corporate law and contract law.[101] Courts sometimes invoke the contract principle and at other times the corporate law prism, and they seemingly do this without a coherent theory.[102] Bratton and Wachter conclude that any apparent inconsistency is dispelled by judicial outcome preference ("the preferred always lose"): "Still, we are left with corporate treatment when corporate treatment benefits the common and contract treatment when contract treatment benefits the common."[103] Why the outcome preference? They answer that Delaware courts ultimately are driven by the "common stock-value maximization norm."[104] This article agrees with their cogent analysis and conclusion. In the realm of stockholder class conflicts, corporate law mandates a priority duty to common stockholders. The opinions in *Equity-Linked*, *Trados* and *LC Capital* clearly state this.

The law of corporate finance shows that, in the absence of bargained for contractual protections, there is a clear preference for the interest of common shareholders over other capital providers. This observation is now trivially obvious with respect to creditors. Corporate law has also recently

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99 LC Capital, 990 A.2d at 448-49 (relying on *HB Korenvaes Investments, L.P. v. Marriott Corp*., 1993 WL 205040 (Del.Ch. 1993)).

100 *Id.* at 452. The trend toward protection of common stockholders has continued. *See* Carsanaro v. Bloodhound Technologies, Inc., 65 A.3d 618 (Del.Ch. 2013).

101 William W. Bratton & Michael L. Wachter, *A Theory of Preferred Stock*, 161 U. PENN. L. REV. 1815, 1821, 1900-01 (2013).

102 *Id.* at 1901.

103 *Id.* at 1901, 1902. *But see* Leo E. Strine, Jr., *Response: Poor Pitiful or Potentially Powerful Preferred?*, 161 U. PENN. L. REV. 2025 (2013).

104 Bratton & Wachter, *supra* note 101, at 1816, 1823, 1824, 1877, 1882, 1905. "The court's disposition to favor the common is unsurprising: Delaware sells a product, the buyers of which tend to be holders of common stock or their management representatives." *Id*. at 1901.

treated preferred stock more like debt by emphasizing contractual rights and less like stock. This trend has left common stock as the clearly preferred securityholder among capital providers. The law mandates that boards must maximize the wealth of common stockholders.

B. Revlon Duty

In the takeover realm, a board ordinarily has significant control of decisions.[105] This discretion may include consideration of "the impact on 'constituencies' other than shareholder (i.e., creditors, customers, employees, and perhaps even the community generally)."[106] However, under *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, a board has a duty to maximize shareholder profit once the object is no longer "to protect or maintain the corporate enterprise but to sell it to the highest bidder."[107] The director's role changes from "defenders of the corporate bastion to auctioneers charged with getting the best price for the stockholders at a sale of the company."[108] In other words, once the board no longer has a future duty to manage the business, its present duty is to maximize value for shareholders.

Beyond an all cash sale of the target,[109] there are three scenarios when *Revlon* applies: (1) when a corporation initiates an active bidding process for sale or breakup of the company; (2) when a target abandons its longterm strategy and acquiesces to a sale of the company to bidder; (3) when a

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105 *See* Stephen M. Bainbridge, *The Geography of Revlon-Land*, 81 FORD. L. REV. 3277, 3286 (2013); Lucian Arye Bebchuk, *The Case Against Board Veto in Corporate Takeovers*, 69 U. CHI. L. REV. 973, 974-75 (2002).

106 Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985). *See* Paramount Communications, Inc. v. Time, Inc., 571 A.2d 1140, 1150 (Del. 1989) ("[A]bsent a limited set of circumstances as defined under Revlon, a board of directors, while always required to act in an informed manner, is not under any *per se* duty to maximize shareholder value in the short term, even in the context of a takeover").

107 506 A.2d 173, 192 (Del. 1986). The *Revlon* duty is not a separate duty independent of the duty of care and loyalty, but "application in a specific context of the board's fiduciary duties of care, good faith, and loyalty." RBC Capital Markets, LLC v. Jervis, 129 A.3d 816, 858 (Del. 2015).

108 *Id.* at 182. *See* McGowan v. Ferro, 859 A.2d 1012, 1032 (Del.Ch. 2004); Equity–Linked Investors, L.P. v. Adams, 705 A.2d 1040, 1054–55 (Del.Ch.1997).

109 Equity-Linked Investors, L.P. v. Adams, 705 A.2d 1040, 1058 (Del.Ch. 1997). An all cash deal is not a precondition to triggering *Revlon*. *See, e.g.,* C&J Energy Services, Inc. v. City of Miami General Employees' & Sanitation Employees' Retirement Trust, 107 A.3d 1049 (Del. 2014) (assuming without deciding that a transaction involving a share exchange in which acquirer shareholders owned 53% and target shareholders 47% of the post-merger company triggered *Revlon*); In re Lukens Inc. S'holders Litig., 757 A.2d 720 (Del.Ch. 1999) (triggering *Revlon* in a mixed cash and stock consideration deal).

transaction results in a change of control.[110] These situations are contextual, and scholars have debated the scope of the *Revlon* duty.[111] The precise contours of *Revlon* duty is not within the scope of this article. The relevance of *Revlon* here is that in a specific transaction zone, *Revlon* provides a rule–sanction framework that mandates shareholder wealth maximization. A decision in the takeover arena is not an ordinary decision. In a change of control of the company, it is the terminal decision. In the *Revlon* zone, a board's final duty is to maximize shareholder profit.

Although *Revlon* is an enforceable rule, it also illustrates the tension between the enforcement of shareholder primacy and the law of managerial authority. Courts do not provide a judicial blueprint for boards to follow.[112] The application of *Revlon* to a transaction and board conduct is not algorithmic. "No court can tell directors exactly how to accomplish that goal, because they will be facing a unique combination of circumstances, many of which will be outside their control."[113] Instead, *Revlon* imposes a heightened judicial scrutiny for reasonableness under which "directors are generally free to select the path to value maximization."[114] Thus, *Revlon* imposes a rule–sanction framework, but courts still accept, with a watchful eye, the primacy of managerial authority as a pragmatic constraint on the assessment of breach and liability.

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110 Arnold v. Soc'y for Sav. Bancorp., Inc., 650 A.2d 1270, 1989-90 (Del. 1994).

111 *See* Stout, *supra* note 33, at 172 ("The case has become nearly a dead letter."); Millon, *supra* note 5, at 1035 ("The *Revlon* duty . . . arises only in a narrow range of circumstances . . . ."); Bainbridge, *supra* note 105, at 3337-38 (providing three circumstances in which *Revlon* duty is triggered); Lyman Johnson & Robert Ricca, *The Dwindling of Revlon*, 71 WASH. & LEE L. REV. 167, 172 (2014) (characterizing *Revlon* as a "narrow, silo-like doctrinal isolation"); Mohsen Manesh, *Defining by Dictum: The Geography of Revlon-Land in Cash and Mixed Consideration Transactions*, 59 VILL. L. REV. 1, 33 (2014) ("The boundaries of *Revlon*-land have never been clearly defined precisely . . . ."); Fisch, *supra* note 5, at 651 ("The *Revlon* decision . . . applies to an extremely small set of cases."); Bruner, *supra* note 52, at 531 (suggesting that the *Revlon* duty "is in fact quite limited").

112 Barkan v. Amsted Industries, Inc., 567 A.2d 1279, 1286 (Del.1989); C & J Energy Services, Inc. v. City of Miami General Employees' and Sanitation Employees' Retirement Trust, 107 A.3d 1049, 1067 (Del. 2014). *See* Unitrin, Inc. v. American General Corp., 651 A.2d 1361, 1374 (Del.1995) ("[E]nhanced judicial scrutiny mandated ... is not intended to lead to a structured, mechanistic, mathematical exercise ... [it is] a flexible paradigm that jurists can apply to the myriad of 'fact scenarios' that confront corporate boards.").

113 Lyondell Chem. Co. v. Ryan, 970 A.2d 235, 242 (Del. 2009).

114 In re Dollar Thrifty S'holder Litig., 14 A.3d 573, 595–96 (Del.Ch. 2010). *See* In re Toys "R" Us, Inc. S'holder Litig., 877 A.2d 975, 1000 (Del.Ch. 2005) ("[T]he enhanced judicial review Revlon requires is not a license for law-trained courts to second-guess reasonable, but debatable, tactical choices that directors have made in good faith.").

C. Market and Architecture

The duties associated with inter-security conflicts and takeovers under *Revlon* are specific transactional situations. The vast majority of managerial decisions in the day-to-day management of a going concern are not subject to a rule–sanction framework.[115] Board decisions are protected by the business judgment rule. If a board determines that the corporation should pay its employees above market wages or incur exceptional cost to surpass regulatory compliance standards on the reason that it would be in "the best interests of the corporation and its shareholders,"[116] this incantation would cloak the board in the shield of the business judgment rule. It would not matter that a plaintiff can demonstrate the merit or demerit of the business decision from a financial viewpoint.[117]

In theory, the law does not seem to hold managers accountable for not pursuing the end of shareholder primacy. Commentators have argued that shareholder primacy is irrelevant in actual business management.[118] The point is correct insofar as a corporate manager has broad authority so long as it acts informedly, disinterestedly, and in good faith.[119] Any rational decision can be justified on some abstract benefit to the long-run interest of the corporation and shareholders. However, the logical end of expansive managerial authority does not necessarily diminish shareholder primacy to a social norm of the business community.

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115 *See supra* Section I.B.

116 *See* Rhee, *supra* note 5, at 699 ("[W]ith the incantation of 'long-term interest of the corporation and shareholders,' the threat of liability is whisked away by the spirit of plausible good faith."). *See also* Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1287 (Del. 1989); In re Walt Disney Co. Derivative Litigation, 906 A.2d 27, 66 (Del. 2006); Unocal v. Mesa Petroleum Co., 493 A.2d 946, 954 (Del. 1985); Gentile v. Rossette, 906 A.2d 91, 103 n.30 (Del. 2006); Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361 (Del.1993); King v. VeriFone Holdings, Inc., 12 A.3d 1140, 1151 (Del. 2011); Unitrin, Inc. v. American General Corp., 651 A.2d 1361, 1373 n.10 (Del. 1995); Moran v. Household Int'l, Inc., 500 A.2d 1346, 1350 (Del. 1985).

117 The fiduciary duty of care in corporate law is an artful concept, under which substantively poor actions are not a breach of care. *See, e.g.*, Brehm v. Eisner, 746 A.2d 244, 264 (Del. 2000) ("Due care in the decisionmaking context is process due care only."); In re Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 967 (Del. Ch. 1996) ("[A] decision substantively wrong, or degrees of wrong extending through 'stupid' to 'egregious' or 'irrational,' provides no ground for director liability"). *See generally* Robert J. Rhee, *The Tort Foundation of Duty of Care and Business Judgment*, 88 NOTRE DAME L. REV. 1139 (2013).

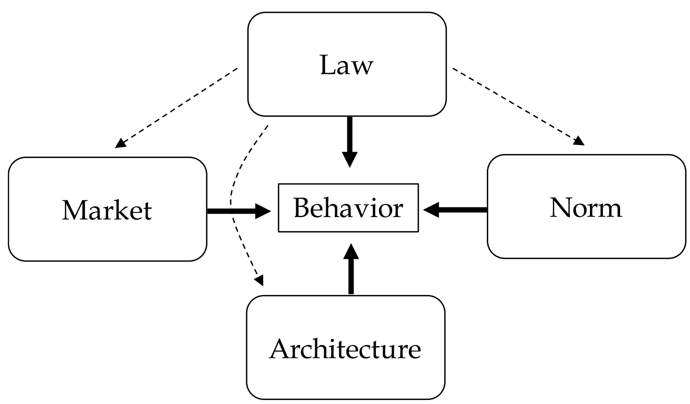
118 *See supra* notes 33, 40, 41 & 49 and accompanying text.

119 *See* STOUT, *supra* note 5, at 31 ("The business judgment rule thus allows directors in public corporations . . . a remarkably wide range of autonomy in deciding what to do with the corporation's earnings and assets.").

The legal system has conceived a better way of achieving the end of shareholder primacy without the complexity and cost of a rule–sanction framework. Let's assume for argument sake that shareholder primacy is the desired policy end (a contestable normative proposition). Corporate law is founded on the principle of the separation of ownership and control and the primacy of managerial authority. How can the law influence managerial behavior toward the end of shareholder primacy?

Lawrence Lessig provides a helpful way to think about the general problem of affecting behavior toward a desired outcome.[120] He suggests that behavior can be regulated by four mechanisms: (1) law in the Austinian sense of a rule backed by the threat of government; (2) social norms through non-legal community enforcement; (3) markets through the device of price; (4) architecture, which he defines as any feature of the world as it is found or made.[121] These four mechanisms affecting behavior are not independent. The law can affect the efficacy of each of the other mechanisms.[122]

Figure 1: Law and Mechanisms Inducing Behavior



For example, the social norm against smoking can be influenced by laws against cigarette advertisement and designation of cordoned smoking spaces. The market for insurance can be used to incentivize seat belt use through subsidization of insurance rates for safe behavior. The architecture of discrimination against the physically handicapped can be diminished by building codes that mandate accessibility. Thus, the law can influence the efficacy of other mechanisms.

This model provides a helpful framework for understanding how corporate law influences managerial behavior toward shareholder primacy.

120 Lawrence Lessig, *The New Chicago School*, 27 J. LEGAL STUDIES 661 (1998).

121 *Id.* at 662-63.

122 *Id.* at 667-69.

The unstated assumption in labeling shareholder primacy as a "norm" is that a *law* of shareholder primacy must be in Austinian form, such as fiduciary duty. Because shareholder primacy cannot be in such form without irreconcilable conflict with managerial authority, it is reduced to the mechanism of norms. This belief is incorrect.

By calling shareholder primacy a norm, we are simply stating the observation that managerial behavior is consistent with shareholder wealth maximization. In other words, *something* is influencing observed behavior, and since a legal duty does not exist, we assume, erroneously, that the cause must be a social norm. The principal cause of inducing conforming behavior is not through the mechanism of a norm, but instead through the mechanisms of law, market and architecture (the latter two being enabled and influenced by law and the legal system writ large). The workings of these three mechanisms, then, legitimize and reinforce an existing norm of the business community.[123]

With respect to the architecture of markets, shareholder primacy tends to be more robust when product competition in the market is strong, as is the case of American markets.[124] An efficient market limits the agency cost of broad managerial control because stock prices would incorporate such cost into valuation. When corporations operate within a liquid capital market, two forms of direct incentives influence managers. The legal system writ large creates a market for corporate control, and it incentivizes executive pay that is substantially linked to share price.

First, the market for corporate control provides the incentive to increase and maintain share price.[125] The laws relating to mergers and acquisitions advance shareholder primacy and directly affect board and managerial incentives and conduct. In a liquid capital market, share price is directly related to shareholder profit maximization. To avoid an unsolicited takeover, managers are incentivized to maximize share price. The pricing mechanism of the market, a feature of architecture supported by law, enforces shareholder primacy.[126]

Second, executive compensation has moved toward a "pay-for-

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123 *See* Cass R. Sunstein, *Social Norms and Social Roles*, 96 COLUM. L. REV. 903, 907 (1996) (suggesting that "government deserves to have, and in any case inevitably does have, a large role in norm management"); Robert C. Ellickson, *The Market for Social Norms*, 3 AM. L. & ECON. REV. 1, 38-42 (2001) (explaining ways in which the government affects norms).

124 Roe, *supra* note 52, at 2063.

125 *See* Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110 (1965).

126 "Hostile takeovers were, and despite the rise of the poison pill still are, an engine of shareholder wealth maximization." Roe, *supra* note 52, at 2074.

performance" model that is linked to share price.[127] The state of executive compensation today has been influenced by law.[128] The current incentive system is linked to shareholder wealth. The phenomenal rise of executive compensation over the past several decades corresponds temporally to the rise of shareholder primacy.[129] As flawed as it currently is,[130] executive compensation is a pricing mechanism for managerial talent and outcomes. The law and the legal system link the stock value of shareholders and the architecture of the corporate system and capital markets. These linkages clearly affect managerial incentive to maximize profit.[131]

If shareholder primacy is only a consensus among managers, shareholders, and academics and subject only to community reprobation, then the most accurate description would fit the definition of a norm. However, the market and the architecture of the corporate system constrain the otherwise expansive legal discretion afforded to corporate managers and steer, partially at least, managerial decisions toward the end of shareholder wealth maximization.[132]

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127 *See* Michael C. Jensen & Kevin J. Murphy, *CEO Incentive—It's Not How Much You Pay, But How*, 68 HARV. BUS. REV. 138 (1990); Michael C. Jensen & Kevin J. Murphy, *Performance Pay and Top-Management Incentives*, 98 J. POL. ECON. 225 (1990).

128 The tax code incentivizes pay-for-performance. *See* I.R.C. § 162(m) (limiting deductibility of executive compensation to $1 million unless it is a qualified performance-based compensation). Absent a breach of duty, corporate law does not review the amount of compensation awarded. *See, e.g.,* In re Walt Disney Co. Derivative Litigation, 906 A.2d 27 (Del. 2006); In re The Goldman Sachs Group, Inc. S'holder Litig., 2011 WL 4826104 (Del.Ch. 2014).

129 *Compare infra* Section III.B and Charts 2 and 3 (showing rise of shareholder primacy in courts since the 1980s), *with* Robert J. Rhee, *Intrafirm Monitoring of Executive Compensation*, 69 VAND. L. REV. 695 (2016) (showing rise of executive compensation since the 1980s). *See also* Rock, *supra* 72, at 1917 ("The biggest development since the 1980s is that CEOs now have large amounts of equity and equity-linked compensation.").

130 A legion of scholarship has been critical of executive compensation based on either the amount of compensation paid or the decoupling of pay and performance. *See, e.g.,* Rhee, *supra* note 129; Gregg D. Polsky, *Controlling Executive Compensation Through the Tax Code*, 64 WASH. & LEE L. REV. 877 (2007); LUCIAN BEBCHUK & JESSE FRIED, PAY WITHOUT PERFORMANCE: THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION (2004). *See also* THOMAS PIKETTY, CAPITAL IN THE TWENTY-FIRST CENTURY 271-303 (2014) (shows how the rise of "supermanagers" has become a major factor of social inequity in the U.S.).

131 *See* Kent Greenfield, *Reclaiming Corporate Law in a New Gilded Age*, 2 HARV. L. & POL'Y REV. 1, 14-15 (2008); STOUT, *supra* note 5, at 71-72; Marcel Kahan & Edward B. Rock, *How I Learned to Stop Worrying and Love the Pill: Adapting Responses to Takeover Law*, 69 U. CHI. L. REV. 871, 884 (2002).

132 *See* Martin Gelter, *The Pension System and the Rise of Shareholder Primacy*, 43 SETON HALL L. REV. 909, 911 (2013) ("Hostile takeovers and, later, equity-based executive

III. SHAREHOLDER PRIMACY IN COURTS 1900–2016

The above rules and aspects of the legal system exemplify the multifaceted mechanism through which shareholder primacy works—through enforceable rules of corporate law in specific transactional spaces and through law-facilitated negative and positive incentives in the corporate system. However, these facets only partially explain the legal mechanism of shareholder primacy. A complete, coherent legal theory, which is set forth in *infra* Section IV, must explain the law's effect on the entire spectrum of managerial conduct. Central to this explanation is the role of courts in advancing shareholder primacy as a rule of law.

This section provides the results of an empirical survey of judicial opinions discussing shareholder wealth maximization in the period 1900 to 2016. It shows that since the 1980s, there has been a marked increase in discussion of shareholder profit maximization in judicial opinions. This phenomenon raises these questions: (1) How did the courts respond to the wave of shareholder-centric consciousness in the business and academic communities? (2) Did the responding judicial discussion, rhetoric, and expectation affect the legal obligations of boards?

A. Methodology and Raw Data

This article surveys judicial opinions discussing the concept of maximizing or increasing shareholder profit in the period from 1900 to 2016, the era of modern corporations and liberal corporate law.[133] A broad search term was used to capture cases that discuss at some level enhancing shareholder economic interest.[134] This article does not claim that the search process produced all judicial decisions that discussed the concept of

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compensation, began to emerge as the new forces creating incentives for managers to focus on share value.").

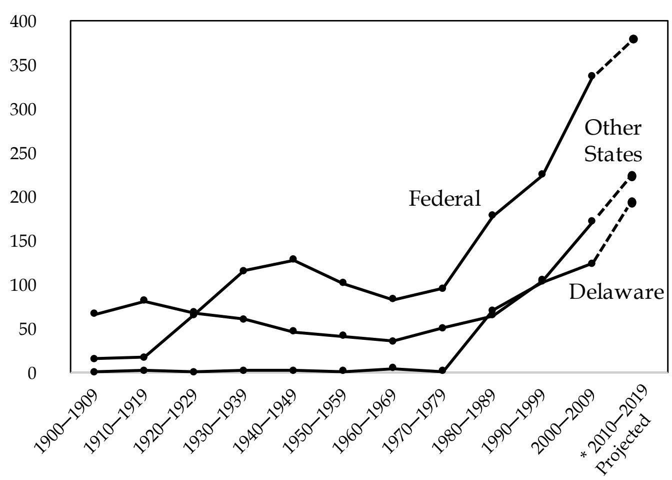
133 The New Jersey Incorporation Act of 1896 was the first liberal corporation statute. Stephen B. Presser & Richard E. Simpson, *Adjusting to the Managerial Revolution: The Law of Corporations in the Federal Courts of Delaware 1900-1941*, 23 WM. & MARY L. REV. 725, 730 (1982). In 1899, Delaware enacted its own liberal corporation statute. *Id.* at 732.

134 The Westlaw state and federal case law directories were searched using this search term: (maximiz! or enhanc! or increas!) /15 (shareholder! or stockholder!) /15 (profit! or wealth! or valu!). The search term was devised to capture statements like this: "Business corporations must engage the political process in instrumental terms if they are to *maximize shareholder value*." Citizens United v. Federal Election Com'n, 558 U.S. 310, 454 (2010) (Stevens, J., concurring and dissenting in part) (emphasis added). No federal or state court opinion has ever used the term "shareholder primacy" independently.

shareholder primacy. The search term is not perfect.[135] Rather, the claim here is that the search process systematically captured a large volume of data over a long period, and the data show distinct patterns of judicial discussion, analysis, and rhetoric throughout the modern era of corporations.

The search criteria produced a raw data set of 3,035 cases. Even the raw, unfiltered data show a distinct pattern. The raw data, shown in Chart 1, suggest that courts have increasingly discussed the idea of maximizing shareholder profit because since the 1980s corporate transactions have sought to achieve that end.[136]

Chart 1: All Judicial Opinions (raw data)



The search term, of course, produced many false positives. Two types of false positive cases were identified and discarded: (1) irrelevant cases

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135 Interestingly, *Dodge v. Ford* does not come up under this search term because the key discussion does not meet the Boolean search criterion: "A business corporation is organized and carried on primarily for the *profit* of the *stockholders*. The powers of the directors are to be employed for that end." 170 N.W. 668, 684 (Mich. 1919) (emphasis added). The missing term is the word derivative "maximize!" or "increase!" or "enhance!" This miss does not undermine the validity of the search criterion. The search term captured many important law cases discussing shareholder primacy. *See, e.g.,* eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1 (Del.Ch. 2010); Paramount Communications, Inc. v. Time Inc., 571 A.2d 1140 (1989); Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1986); Katz v. Oak Industries, Inc., 508 A.2d 873 (Del.Ch. 1986).

136 Charts showing data for the decade 2010–2019 present actual data for the 7-year period 2010–2016 and linear extrapolations for the remaining 3-year period 2017–2019.

that are just random hits from the Boolean search term;[137] (2) cases where the idea of maximizing shareholder wealth was raised by a party or was a point of fact, such as a statement in a press release or proxy, but the court did not directly engage this assertion with its own voice.[138] This second type of case could be relevant to some broader analysis of shareholder primacy, but recitations of facts do not reveal judicial thinking. Thus, under the method here, they are strictly irrelevant cases.

Although the second type of false positives were discarded, they yield three pertinent observations. First, not surprisingly, corporate litigants, both shareholders and managers, routinely invoke the concept of profit maximization when advancing a complaint or a defense. This type of case was far more numerous than random hits. Since the 1980s, parties have inundated courts with transactions and claims asserting shareholder profit maximization. Second, again not surprisingly, courts do not reproach corporate litigants for advancing facts or arguments based on shareholder wealth maximization.[139] At minimum, court have not found the concept inconsistent with corporate law; more likely, they have tacitly accepted the principle as a part of corporate law and governance. Third, the case law reveals that the lexicon of "maximizing" shareholder wealth, vis-à-vis "increasing" or "enhancing," is ubiquitous. This clearly preferred linguistic choice expresses the maximand as the corporate purpose.[140]

B. Rise of Shareholder Primacy in Courts

The culling of false positives produced a final list of cases where the court discussed in its own voice and thought the concept of shareholder primacy. Relevant cases were, then, further sorted into two broad categories: *Revlon*-invoking cases and non-*Revlon* cases. Because *Revlon*

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137 *See, e.g.*, ev3, Inc. v. Lesh, 114 A.3d 527, 540 (Del. 2015) (discussing maximization of earn-outs).

138 *See, e.g.*, Bank of N.Y. Mellon Trust Co., N.A. v. Liberty Media Corp., 29 A.3d 225, 231-32 (Del. 2011) (quoting the company's CEO).

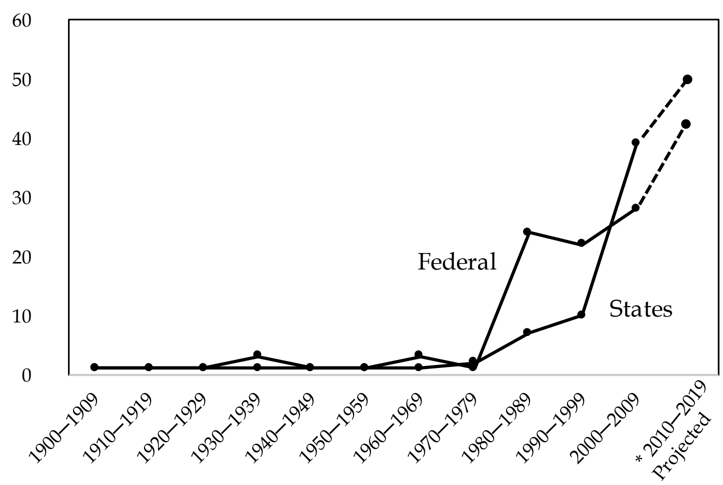
139 When courts explicitly reject the concept, they were bound by state constituency statutes. *See* Murray v. Conseco, Inc., 766 N.E.2d 38, 44 (Ind.App. 2002) (Indiana statute); Dixon v. Ladish Co., Inc., 785 F.Supp.2d 746, 753 (E.D.Wisc. 2011) (Wisconsin statute); Stilwell Value Partners I, L.P. v. Prudential Mut. Holding Co., 2008 WL 1900945, at *13 (E.D.Pa. 2008) (Pennsylvania statute); Shepard v. Meridian Ins. Group, Inc., 137 F.Supp.2d 1096, 1113 (S.D.Ind. 2001) (Indiana statute); In re Guidant Corp. Shareholders Derivative Litig., 2006 WL 290524, at *7-8 (S.D.Ind. 2006) (Indiana statute); In re PHLCORP, 1992 WL 85013, at *9 (S.D.N.Y. 1992) (Pennsylvania statute). Only a few courts or judges have argued against profit maximization independent of constituency statutes. *See* Day v. Staples, Inc., 555 F.3d 42, 56 (1st Cir. 2009); Bonoff v. Troy, 187 A.D.2d 302, 303 (N.Y.App.Div. 1st Dep't 1992); Flamm v. Eberstadt, 814 F.2d 1169, 1182 (7th Cir. 1987) (Cudahy, J., concurring).

140 *See infra* Section III.B and Table 4.

mandates an enforceable duty to maximize shareholder wealth, *Revlon*-invoking cases are uninteresting in the sense that they must recite the rule in *Revlon* even if a court ultimately determined that the transaction does not come within the *Revlon* zone. Non-*Revlon* cases are more revealing because any comment by the court, speaking in its own voice, reveals its thought process on shareholder wealth maximization when it is not required to do so under the *Revlon* rule or a required recitation thereof.

Mirroring the raw data, the refined data shows that judicial discussion of shareholder-centric concepts have figured prominently in corporate litigation starting in the 1980s. The chart below shows federal and state non-*Revlon* cases.

Chart 2: Non-*Revlon* Federal and State Cases

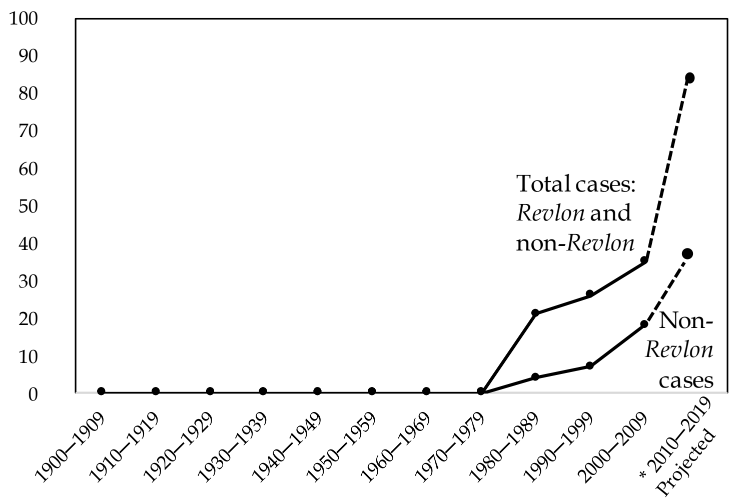


The Delaware experience is consistent with the above data. Delaware cases show that judicial discussion of shareholder-centric concepts have figured prominently in corporate litigation starting in the 1980s. The table and the chart below provide the data, categorized into *Revlon* and non-*Revlon* cases.

Table 1: Delaware cases from 1900 to 2016

Period	Revlon	Non-Revlon	Total Cases
1900—1979	0	0	0
1980—1989	17	4	21
1990—1999	19	7	26
2000—2009	17	18	35
2010—2016	35	25	60
1900—2016	88	54	142

Chart 3: Delaware Cases



Charts 2 and 3 show that in the period 1900–1979 courts were virtually silent on the concept of shareholder primacy. The hockey stick pattern of cases should not be surprising in light of well-known economic, business, and intellectual histories. It is confirming. The increased discussion of maximizing shareholder profit is associated with economic and legal ideas on the theory of the firm and agency cost from the 1970s and 1980s, which provide the theoretical foundation of shareholder primacy.[141] The 1980s brought forth "tectonic forces" in the form of hostile takeovers, innovations in junk bond financing, economic globalization, and sustained economic arguments in the business and academic communities for profit maximization.[142] The case law, embodying the collective judicial thinking,

141 *See supra* note 51.

142 In the twentieth century, there had always been two competing conceptions of the corporation: the "property conception" that views the corporation as the private property of shareholders, and the "society entity conception" that views the corporation as a social

reflects these developments. The table below tracks the number of cases by decades.

Table 2: Non-*Revlon* cases from 1900 to 2016

Period	Delaware	Other States	Federal
1900—1909	0	1	1
1910—1919	0	1	1
1920—1929	0	1	1
1930—1939	0	3	1
1940—1949	0	1	1
1950—1959	0	1	1
1960—1969	0	1	3
1970—1979	0	2	1
1980—1989	4	3	24
1990—1999	7	3	22
2000—2009	18	21	28
2010—2016	25	10	30

We can also pinpoint the rise of shareholder primacy in courts to a specific point in the 1980s. The years 1980-1984 were unremarkable and looked very similar to the 1970s in the number of cases. In the time period 1900 to 1984, the search criteria produced no Delaware case that discussed

entity endowed with a social purpose. William T. Allen, *Our Schizophrenic Conception of the Business Corporation*, 14 CARDOZO L. REV. 261 266-72 (1992); ADOLPH A. BERLE, POWER 206 (1967). These two conceptions have coexisted in an uneasy détente for much of the twentieth century. Allen *supra* at 264-65; BERLE, *supra* at 206. The 1980s brought to the surface the underlying tensions between the two conceptions of the corporation.

> The dynamic forces in corporation law are easy to identify. The evolution of the junk bond market and takeover entrepreneurs, the growth of institutional investors, and the striking emergence of a global economy came together in the 1980s to force massive change in the private sector of our economy. In that process, tensions and antinomies in corporation law theory that had been lying beneath the surface for a very long time, were forced out into the open. As a result, during the 1980s corporation law became not boring and marginal, but important, even fascinating. Articles on corporate theory found their way into leading journals. Basic questions excited argument, and the most basic questions—What is a corporation? What purpose does it serve?—became the stuff of wide discussion and of statutory activity. Everything old became new again.

Allen, *supra*, at 263-64.

shareholder primacy in its own voice.[143] The first case in Delaware was in 1985, the seminal decision by the Delaware Supreme Court in *Moran v. Household International, Inc*. where the court validated the poison pill.[144] In that year, the court also decided several other landmark cases in the takeover realm.[145] In 1986, portending the new era of shareholder-centrism, Delaware courts decided two seminal cases in corporate law, which partially but substantially advanced shareholder primacy in specific transactional spaces: *Katz v. Oak Industries, Inc*. and *Revlon v. MacAndrews & Forbes Holdings, Inc*.[146] The table below tracks the number of cases in each year of the decade.[147]

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143 Only one case could be read as dealing with profit maximization. In *Warshaw v. Calhoun*, 213 A.2d 539 (Del.Ch. 1965), a minority shareholder of a personal holding company complained that the controlling shareholder was depressing the stock value of the company by maintaining too large of an investment stake in a portfolio company. The court held that the board is not required to reduce its investment stake. *Id.* at 542-43. Thus, *Warshaw* unremarkably upholds managerial authority over a shareholder's assertion of a strategy to maximize profit.

144 490 A.2d 1059 (Del. 1985). "The very fact that the director wants to enhance corporate profits is in part attributable to his desire to keep shareholders satisfied so that they will not oust him." *Id.* at 1074.

145 *See* Unocal v Mesa Petroleum Co., 493 A2d 946, 955-56 (Del 1985); Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985).

146 *See supra* Sections II.A and II.B.

147 **Delaware:** Paramount Communications, Inc. v. Time, Inc., 1989 WL 79880 (Del.Ch. 1989); In re Resorts Intern. Shareholders Litigation, 1988 WL 92749 (Del.Ch. 1988); Katz v. Oak Industries Inc., 508 A.2d 873 (Del.Ch. 1986); Moran v. Household Intern., Inc., 490 A.2d 1059 (Del. 1985). An important case in the takeover field, *Paramount Communications, Inc. v. Time Inc.*, is not included in this list because there was no explicit embrace of shareholder primacy: "a board of directors, while always required to act in an informed manner, is not under any per se duty to maximize shareholder value in the short term, even in the context of a takeover." 571 A.2d 1140, 1150 (Del. 1989).

States: Houser v. Philadelphia Gas Commission, 1986 WL 501533 (Pa.Ct. Common Pleas 1986); El Paso Elec. Co. v. New Mexico Public Serv. Com'n, 706 P.2d 511, 513-14 (N.M. 1985); Alpert v. 28 Williams Street Corp., 473 N.E.2d 19, 28 (N.Y. 1984).

Federal: McCain v. Phoenix Resources, Inc., 1989 WL 146212, at *6 (S.D.N.Y. 1989); Newell Co. v. Vermont American Corp., 725 F.Supp. 351, 375 (N.D.Ill. 1989); Estate of Detwiler v. Offenbecher, 728 F.Supp. 103 (S.D.N.Y. 1989); Gray v. Zondervan Corp., 712 F.Supp. 1275, 1281-82 (W.D.Mich. 1988); Gillette Co. v. RB Partners, 693 F.Supp. 1266, 1274 (D.Mass. 1988); Field v. Trump, 850 F.2d 938, 948 (2d Cir. 1988); Terrydale Liquidating Trust v. Barness, 846 F.2d 845, 847-48 (2d Cir. 1988); Desert Partners, L.P. v. USG Corp., 686 F.Supp. 1289, 1297(N.D.Ill. 1988); Basic Inc. v. Levinson, 485 U.S. 224, 235 (1988); Samjens Partners I v. Burlington Industries, Inc., 663 F.Supp. 614, 626 (S.D.N.Y. 1987); Champion Parts Rebuilders, Inc. v. Cormier Corp., 650 F.Supp. 87, 88-89 (N.D.Ill. 1986); Harvard Industries, Inc. v. Tyson, 1986 WL 36295, at *2 (E.D.Mich. 1986); Spinner Corp. v. Princeville Development Corp., 1986 WL 15545, at *8 (D. Hawaii 1986); Dynamics Corp. of America v. CTS Corp., 805 F.2d 705, 708 (7th Cir. 1986); Terrydale Liquidating Trust v. Barness, 642 F.Supp. 917, 923 n.5 (S.D.N.Y. 1986); Dynamics Corp. of America v. CTS Corp., 638 F.Supp.

Table 3: Non-*Revlon* cases in the 1980s

Year	Delaware	Other States	Federal
1980	0	0	3
1981	0	0	2
1982	0	0	0
1983	0	0	0
1984	0	1	1
1985	1	1	0
1986	1	1	8
1987	0	0	1
1988	1	0	6
1989	1	0	3

During the leveraged financed merger boom of the late 1980s and early 1990s, the debate on profit maximization was largely in the takeover arena. Since then, the takeover arena has continued to be the focus of the debate on the purpose of the corporation and shareholder wealth maximization.[148] The years 1985-1986 mark an inflection point, at which time courts began to opine on shareholder primacy and the trend has been unabated since then (see Charts 2 and 3).

The rise of shareholder primacy is also marked by a significant shift in lexicon. Before the mid-1980s, when courts discussed shareholder profit, they tended to use the word choice "increasing" or "enhancing" profit, indicating an obligation to make a profit without stating a maximand or prioritizing the purpose of a corporation. Since 1985, "maximizing" profit has become the dominant term in the conversation in corporate transactions and litigation, which reflects the belief held by shareholders and

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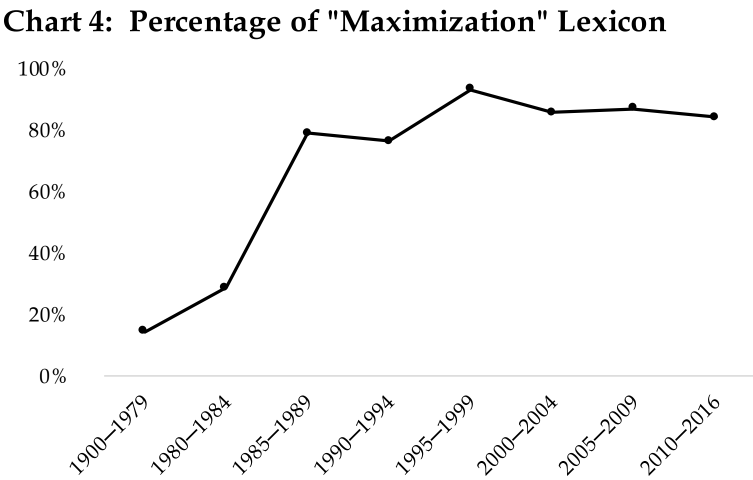
802, 805 (N.D.Ill. 1986); Dynamics Corp. of America v. CTS Corp., 794 F.2d 250, 255 (7th Cir. 1986); Dynamics Corp. of America v. CTS Corp., 635 F.Supp. 1174, 1179 (N.D.Ill. 1986); Leigh v. Engle, 727 F.2d 113, 128 (7th Cir. 1984); General Portland, Inc. v. LaFarge Coppee S.A., 1981 WL 1408 (N.D.Tex. 1981); Panter v. Marshall Field & Co., 646 F.2d 271, 294 (7th Cir. 1981); Crouse-Hinds Co. v. InterNorth, Inc., 518 F.Supp. 390, 407 (N.D.N.Y. 1980); Johnson v. Trueblood, 629 F.2d 287, 292 (3d Cir. 1980); United Operating Co. v. Karnes, 482 F.Supp. 1029, 1030-31 (S.D.N.Y. 1980).

148 *See* Paramount Communications, Inc. v. QVC Network, Inc., 637 A.2d 34 (Del. 1994); Paramount Communications, Inc. v. Time Inc., 571 A.2d 1140 (Del. 1990); William T. Allen, Jack B. Jacobs & Leo E. Strine, Jr., *The Great Takeover Debate: A Meditation on Bridging the Conceptual Divide*, 69 U. CHI. L. REV. 1067, 1071 (2002); Allen, *supra* note 142, at 263.

management.[149] Chart 4 tracks the use of the term "maximize" in federal and state judicial opinions from the period 1900–2016 as a percentage of total cases indicating an obligation to "increase," "enhance," or "maximize" shareholder profit.



The shift in rhetoric is definitionally and legally significant. Enhance is defined as an increase.[150] Maximize is defined as an increase to a maximum,[151] and it connotes the economic concept of a maximand. The choice of term has legal significance. Corporate law statutes of all fifty states and the Model Business Corporation Act do not mandate the purpose of the business corporation. However, the American Law Institute's Principles of Corporate Governance addresses the issue. It provides: "a corporation should have its objective the conduct of business activities with a view to *enhancing* corporate profit and shareholder gain."[152] The ALI choice of the term "enhancing" was deliberate. It reveals a reluctance to embrace a strong form of shareholder primacy; or stated more strongly, it rejects economic efficiency as *the* purpose of the corporation.[153] Thus, the sudden shift in the judicial choice of terms in the mid-1980s reveals an awareness and embrace of the concept of maximand.

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149 The term "profit maximization" has long been in public and academic discussion. *See, e.g.*, GALBRAITH, *supra* note 3, at 113 (1967).

150 WEBSTER'S NINTH NEW COLLEGIATE DICTIONARY 413 (1986).

151 *Id.* at 734.

152 AMERICAN LAW INSTITUTE'S PRINCIPLES OF CORPORATE GOVERNANCE § 2.01 (1994) (emphasis added).

153 Bratton, *supra* note 5, at 714. *See* AMERICAN LAW INSTITUTE'S PRINCIPLES OF CORPORATE GOVERNANCE § 2.01(b)(2), (3) (1994) (discussing ethical implications of shareholder primacy).

C. *Integration and Dutification*

The nature of the judicial discussion has evolved with judicial embrace of the concept of shareholder primacy becoming stronger over time. To show this phenomenon, this article categorizes non-*Revlon* cases into four types of cases reflecting various degrees of judicial embrace. *Recognition* indicates cases where the court states as a point of fact or observation that directors or shareholders seek to maximize profit, thus recognizing shareholder primacy at the factual level of business practice.[154] *Application* indicates cases where the court applies the concept of shareholder primacy in the process of reasoning toward the case holding or issue resolution.[155] *Integration* indicates cases where the court uses the concept as a rationale for another principle or rule of corporate law, thus integrating the concept into the rule of law.[156] *Dutification* indicates cases where the court prescribes profit maximization as a managerial obligation, thus clearly expressing shareholder primacy as a legal obligation.[157]

These four categories present an increasing spectrum of judicial endorsement of shareholder primacy: from embracing the concept at the factual level to incorporating the principle at the level of law and legal obligation. Chart 5 provides the number of cases by these four categories in the period 1980 to 2019 (projected).

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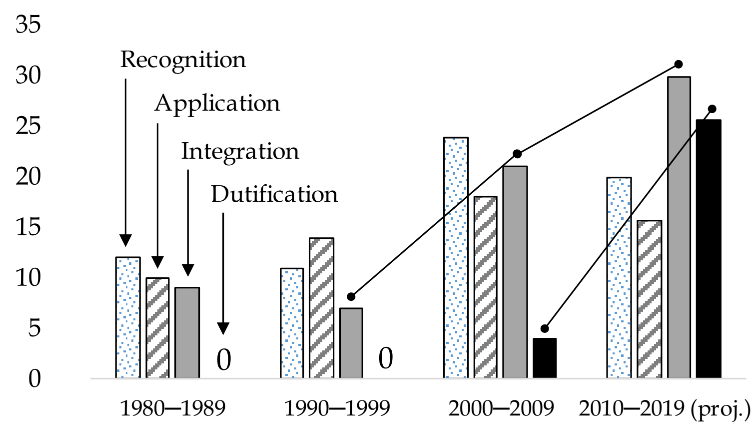
154 *See, e.g.*, In re Dunkin' Donuts Shareholders Litigation, 1990 WL 189120, at *9 (Del.Ch. 1990) ("Stockholders, on the other hand, do not care if the bidder gets a 'good deal,' they want the most compensation available for their holding in the company. As recent cases in this Court illustrate, maximization of shareholder value is often achieved through an auction of a target company.").

155 *See, e.g.*, In re IXC Communications, Inc. v. Cincinnati Bell, Inc., 1999 WL 1009174, at *5 (Del.Ch. 1999) ("It seems that at this preliminary stage that, absent a complete review of the facts, that the IXC board's judgments about what deals and offers might have been more or less viable than others reflect a vigorous process for maximizing shareholder value. I have not been presented facts that would allow me to conclude that the IXC board did not exercise its best judgment in deciding which suitors merited serious consideration and which ones perhaps did not.").

156 *See, e.g.*, Katz v. Oak Industries, Inc., 508 A.2d 873, 879 (Del.Ch. 1986) ("It is the obligation of directors to attempt, within the law, to maximize the long-run interests of the corporation's stockholders; that they may sometimes do so 'at the expense' of others (even assuming that a transaction which one may refuse to enter into can meaningfully be said to be at his expense) does not for that reason constitute a breach of duty.").

157 *See, e.g.,* In re Trados Inc. S'holder Litig., 73 A.3d 17, 20 (Del.Ch. 2013) ("Directors of a Delaware corporation owe fiduciary duties to the corporation and its stockholders which require that they strive prudently and in good faith to maximize the value of the corporation for the benefit of its residual claimants.").

Chart 5: State and Federal Non-*Revlon* Cases



The number of total cases are increasing with time. The above chart shows that cases in the categories of integration and dutification, the highest level of judicial embrace, are increasing. Also, note that dutification cases are a recent phenomenon, and since 2000 their numbers have increased significantly.

The concept of shareholder primacy has been integrated into a number of legal principles and rules of law. An example of integration is seen in *In re Pure Resources, Inc. Shareholders Litigation*.[158] The controlling shareholder made a tender offer to minority shareholders with an intended backend short-form merger. The court noted that there were two plausible options for the standard of judicial review, the choice of which would be critical to the outcome of any corporate litigation.[159] The Delaware chancery court discussed the underlying policy and principle guiding the choice of rule.[160]

> . . . Much of the judicial carpentry in the corporate law occurs in this context, in which judges must supplement the broadly enabling features of statutory corporation law with equitable principles sufficient to protect against abuse and unfairness, but not so rigid as to stifle useful transactions that *could increase the shareholder and societal wealth generated by the corporate form*.
>
> In building the common law, judges forced to balance these concerns cannot escape making normative choices, based on

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[158] 808 A.2d 421, 424 (Del.Ch. 2002) (Strine, V.C.).

[159] *Id.* at 433. *Compare* Kahn v. Lynch Communications Systems, Inc., 638 A.2d 1110, 1117 (Del. 1994), *with* Solomon v. Pathe Communications Corp., 672 A.2d 35, 39-40 (Del. 1996).

[160] 808 A.2d at 434-35 (emphasis added).

> imperfect information about the world. This reality clearly pervades the area of corporate law implicated by this case. When a transaction to buy out the minority is proposed, is it more important to the development of strong capital markets to hold controlling stockholders and target boards to very strict (and litigation-intensive) standards of fiduciary conduct? Or *is more stockholder wealth generated* if less rigorous protections are adopted, which permit acquisitions to proceed so long as the majority has not misled or strong-armed the minority? . . .

The court adopted the rule of law that advanced the policy consideration in favor of profit maximization.[161]

The number of integration cases are significant and increasing. Many corporate law doctrines, as well as doctrines from other fields of law such as securities regulation, contracts, bankruptcy, and ERISA, have been explicitly justified on the rationale of shareholder wealth maximization.

Difference in duties between nonprofit and for profit corporations.—Courts have imposed different rules on public nonprofit entities. These rules are justified on the rationale that nonprofit and for profit corporations have different purposes. Managers of a business corporation are "guided by their duty to maximize long term profit for the benefit of the corporation and the shareholders."[162] However, a nonprofit corporation's purpose is not to generate a profit and instead the board's duty of loyalty is to pursue the charitable or public benefit mission.[163]

Business judgment rule.—A foundational rule in corporate law is the business judgment rule, which grants the board broad discretion to manage the business and affairs of the corporation absent a showing of a breach of fiduciary duty. The business judgment rule has been justified on the rationale: "Through the business judgment rule, Delaware law encourages corporate fiduciaries to attempt to increase stockholder wealth by engaging in those risks that, in their business judgment, are in the best interest of the corporation without the debilitating fear that they will be held personally liable if the company experiences losses."[164]

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161 *Id.* at 444 (adopting the *Solomon* standard).

162 Summers v. Cherokee Children & Family Services, Inc., 112 S.W.3d 486, 503-04 (Tenn.App. 2002). *Accord* State ex rel. Little People's Child Development Center, Inc. v. Little People's Child Development Center, Inc., 2009 WL 103509, at *7 (Tenn.App. 2009).

163 Summers, 112 S.W.3d at 503-04.

164 In re Goldman Sachs Group, Inc. S'holder Litig., 2011 WL 4826104, at *23 (Del.Ch. 2011) (quoting In re Citigroup Inc. Shareholder Derivative Litigation, 964 A.2d 106, 139

Corporate charter.—Corporate charters permit corporations to pursue profit maximization in diverse ways, subject to the requirement that the corporation engage in "lawful business" and "lawful acts."[165]

Shareholder voting rights.—A foundational rule in corporate law is that shareholders have governance rights through voting. This rule has been justified on the rationale that "[w]hat legitimizes the stockholder vote as a decision-making mechanism is the premise that stockholders with economic ownership are expressing their collective view as to whether a particular course of action serves the corporate goal of stockholder wealth maximization."[166]

Derivative suits.—A foundational rule in corporate law is that shareholders may bring a derivative suit on behalf of the corporation. This form of action has been justified on the rationale that shareholders can "pursue monitoring activities that are wealth increasing for the collectivity (the corporation or the body of its shareholders)."[167] Instrumental aspects of derivative suits, such as attorney fees[168] and the demand requirement[169], have been justified on the rationale of shareholder wealth.

Shareholder inspection rights.—Corporate law permits shareholders certain inspection rights. A shareholder must have a credible basis for showing mismanagement, waste, or wrongdoing for compel an inspection of the books and records. This rule has been justified on the rationale that it "maximizes stockholder value by limiting the range of permitted stockholder inspections to those that might have merit."[170]

Creditor's standing to bring derivative suit.—A well-established rule in

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(Del.Ch. 2009)). *Accord* In re Ambac Financial Group, Inc., 457 B.R. 299, 305 (S.D.N.Y. Bankr. 2011); In re Citigroup Inc. Shareholder Derivative Litigation, 964 A.2d 106, 139 (Del.Ch. 2009); Granada Investments, Inc. v. DWG Corp., 823 F.Supp. 448, 454 (N.D. Ohio 1993); Panter v. Marshall Field & Co., 646 F.2d 271, 294 (7th Cir. 1981); Crouse-Hinds Co. v. InterNorth, Inc., 518 F.Supp. 390, 407 (N.D.N.Y. 1980); Johnson v. Trueblood, 629 F.2d 287, 292 (3d Cir. 1980).

165 In re Massey Energy Co., 2011 WL 2176479, at *20 & n.144 (Del.Ch. 2011) (citing ROBERT CHARLES CLARK, CORPORATE LAW § 1.2, at 18 (1986)).

166 Crown EMAK Partners, LLC v. Kurz, 992 A.2d 377, 388 (Del. 2010). *Accord* In re CNX Gas Corp. Shareholders Litigation, 4 A.3d 397, 416 (Del.Ch. 2010); Kurz v. Holbrook, 989 A.2d 140, 178-79 (Del.Ch. 2010).

167 In re Activision Blizzard, Inc., 86 A.3d 531, 548 (Del.Ch. 2014) (quoting Bird v. Lida, Inc., 681 A.2d 399, 403 (Del.Ch.1996)). *Accord* Keller v. Estate of McRedmond, 495 S.W.3d 852, 868 (Tenn. 2016); Case Financial, Inc. v. Alden, 2009 WL 2581873, at *7 n.41 (Del.Ch. 2009).

168 In re Del Monte Foods Co. Shareholders Litigation, 2011 WL 2535256, at *14 n.5 (Del.Ch. 2011); In re Sauer-Danfoss Inc. Shareholders Litigation, 65 A.3d 1116, 1140 n.7 (Del.Ch. 2011).

169 Johnson v. Glassman, 950 A.2d 215, 220 (N.J.Super. 2008).

170 Seinfeld v. Verizon Communications, Inc., 909 A.2d 117, 125 (Del. 2006).

corporate law is that creditors have standing to bring derivative suits for a breach of fiduciary duty when a corporation is in insolvency. This rule has been justified on the rationale that it comports with the "directors' duty to maximize the value of the insolvent corporation for the benefit of all those having an interest in it."[171]

Maximization of residual value.—A related concept to a creditor's standing to bring a derivative action is the rule that requires a manager or trustee to maximize the value of the firm in insolvency, including value as to shareholders. This rule has been justified on the rationale that "strive in good faith and on an informed basis to maximize the value of the corporation for the benefit of its residual claimants, the ultimate beneficiaries of the firm's value."[172] This rationale is the same one that supports profit maximization as the economically efficient goal, which is the maximization of a firm's residual value. Outside of insolvency, the residual value in assets and earnings belong to shareholders.

Priority rule in bankruptcy.—A fundamental concept in bankruptcy and corporate law is that creditors must be paid before shareholders. In bankruptcy under the rule of absolute priority, creditors are paid first in the order of seniority. In corporate law under the rule of limited liability, the claims of creditors are protected ahead of shareholder interest in the corporation. These rule are justified on the rationale: "Because, unlike creditors and depositors, stockholders stand to gain a share of corporate profits, stockholders should take the primary risk of the enterprise failing. This scheme of priorities is consistent with the economic theory of

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171 N. Am. Catholic Educ. Prog. Foundation, Inc. v. Gheewalla, 930 A.2d 92, 103 (Del. 2007). *Accord* In re AWTR Liquidation Inc., 548 B.R. 300, 328 n.12 (C.D.Cal. Bankr. 2016); Caulfield v. Packer Group, Inc., 56 N.E.3d 509, 518 (Ill.App. 2016); Lichtenstein v. Willkie Farr & Gallagher LLP, 120 A.D.3d 1095, 1097 (N.Y.Sup. 1st App.Div. 2014); In re Grace Manor Health Care Facility, Inc., 2012 WL 1021036, at *2 (W.D.N.Y. Bankr. 2012); Sanford v. Waugh & Co., Inc., 328 S.W.3d 836, 845 (Tenn.Super. 2010); Production Resources Group, L.L.C. v. NCT Group, Inc., 863 A.2d 772, 777, 787, 790-91 (Del.Ch. 2004); Official Committee of Bond Holders of Metricom, Inc. v. Derrickson, 2004 WL 2151336, at *3 (N.D.Cal. 2004); In re RSL COM PRIMECALL, Inc., 2003 WL 22989669, at *8 (S.D.N.Y. Bankr. 2003).

172 Quadrant Structured Products Co., Ltd. v. Vertin, 102 A.3d 155, 172, 176 (Del.Ch. 2014) (quoting In re Trados Inc. S'holder Litig., 73 A.3d 17, 40-41 (Del.Ch.2013)). *Accord* Badii ex rel. Badii v. Metropolitan Hospice, Inc., 2012 WL 764961, at *9 (Del.Ch. 2012); In re JL Building, LLC, 452 B.R. 854, 862 (D. Utah Bankr. 2011); In re C.W. Mining Co., 636 F.3d 1257, 1264-65 (10th Cir. 2011); In re Amcast Indus. Corp., 365 B.R. 91, 104 n.6, 107 n.7 (S.D. Ohio 2007); Mukamal v. Bakes, 383 B.R. 798, 826 (S.D.Fla. 2007); In re Hechinger Investment Co. of Delaware, 274 B.R. 71, 89 (D.Del. 2002); Terrydale Liquidating Trust v. Barness, 846 F.2d 845, 847-48 (2d Cir. 1988).

corporations."[173]

Restructuring and exchange offers.—In a restructuring or other corporate transactions, the economic value of debt instruments may be diminished to enhance shareholder value. Such transactions are justified on the rationale: "It is the obligation of directors to attempt, within the law, to maximize the long-run interests of the corporation's stockholders; that they may sometimes do so 'at the expense' of others . . . does not for that reason constitute a breach of duty."[174]

Mergers and acquisitions.—The poison pill has long been used a takeover defense. Courts have noted that the poison pill may have value maximizing uses.[175] The poison pill has been justified on the rationale that it is "plausibly related to the goal of stockholder wealth maximization."[176] A number of other issues and rules in the takeover context has been justified on the rationale of shareholder profit maximization.[177]

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173 Gaff v. Federal Deposit Ins. Corp., 919 F.2d 384, 392 (6th Cir. 1990).

174 Katz v. Oak Industries Inc., 508 A.2d 873, 879 (Del.Ch. 1986). *Accord* U.S. Bank Nat. Ass'n v. Stanley, 297 S.W.3d 815, 820 (Tex.App. 2009).

175 Moore Corp. Ltd. v. Wallace Computer Services, Inc., 907 F.Supp. 1545, 1557 (D.Del. 1995) (citing City Capital Assoc. v. Interco Inc., 551 A.2d 787, 798 (Del.Ch.1988)).

176 Cooperstock v. Pennwalt Corp., 820 F.Supp. 921, 924 (E.D.Pa. 1993). *Accord* Desert Partners, L.P. v. USG Corp., 686 F.Supp. 1289, 1297(N.D.Ill. 1988); Dynamics Corp. of America v. CTS Corp., 805 F.2d 705, 708 (7th Cir. 1986) (Posner, J.).

177 *See* Employer Teamsters Local Nos. 175 & 505 Pension Trust Fund v. Caspersen, 2006 WL 435289, at *8 (N.J.Sup. 2006) (duty to inform in a merger "maximize[s] the value obtained for their shareholders"); In re CompuCom Systems, Inc. Stockholders Litigation, 2005 WL 2481325, at *6 (Del.Ch. 2005) ("The reasons for the law's tolerance of [sale of controlling stake] is clear—as the owner of a majority share, the controlling shareholder's interest in maximizing value is directly aligned with that of the minority."); Alessi v. Beracha, 849 A.2d 939, 947 (Del.Ch. 2004) ("secrecy increases shareholder wealth" in the context of sale of the company); Marcoux v. Prim, 2004 WL 830393, at *13 (N.C.Super. 2004) ("This Court must balance protecting shareholder rights with preserving the freedom of shareholders to approve or block a proposed merger according to their own economic interests. A standard that is too lenient in either direction can have adverse repercussions on both shareholder rights and maximizing shareholder value."); Fulk v. Washington Service Associates, Inc., 2002 WL 1402273, at *7 (Del.Ch. 2002) (noting the "the larger question—how best to maximize value for the shareholders in a sale of the Company" in a dissolution and liquidation); Blanchard v. Edgemark Financial Corp., 2000 WL 33223385, at *3 (N.D.Ill. 2000) ("Secrecy maximizes shareholder wealth in the context of public corporations by encouraging potential bidders to offer their most aggressive price on a deal."); ACE Ltd. v. Capital Re Corp., 747 A.2d 95, 104-05 (Del.Ch. 1999) (noting that "the Delaware law of mergers and acquisitions has given primacy to the interests of stockholders in being free to maximize value from their ownership of stock without improper compulsion from executory contracts entered into by boards"); Avon Products, Inc. v. Chartwell Associates L.P., 738 F.Supp. 686, 689 & n.2 (S.D.N.Y. 1990) (explaining certain statutory merger rules as presumably "an effort to maximize stockholder value"); Terrydale Liquidating Trust v. Barness, 642 F.Supp. 917, 923 n.5 (S.D.N.Y. 1986) (indicating

Shareholder proxy.—A proxy rule proposed by the SEC related to the direct nomination and election of directors by shareholders was recently litigated in a prominent case. The court struck down the proposed rule and justified the decision on the rationale that the rule did not establish a connection to "the goal of maximizing shareholder value . . . [and] the privilege also leaves corporate officers freer to exercise their business judgment in their shareholders' best interests."[178]

Contract privilege.—In some states, corporate officers are privileged to interfere with contracts. This rule is justified on the rationale that the "privilege maximizes firm value by incentivizing officers to prioritize the interests of shareholders over those of contract creditors."[179]

ERISA.—Courts circumscribe the exercise of discretion of an ERISA plan administrator and engages in judicial review of the administrator's conduct. This rule is justified on the rationale that "as the insurer, [it] reaps the financial rewards of its claims decisions, and, as a subsidiary of a publicly held and traded corporation, has a conflicting fiduciary obligation to maximize profits for the benefit of shareholders."[180]

In conclusion, a review of the above integration cases shows that shareholder primacy is like a filamentary principle that weaves through many important rules of corporate law and the corporate system. Courts have recognized that shareholder profit is the rationale for many important or foundational rules of corporate law.

In addition to integration cases, the case law also shows the beginning, perhaps, of explicit rule of law emerging in the form of an unconditional obligation to maximize shareholder wealth. This is a recent phenomenon. Before 2000, there were no dutification cases. In the period 2000–2009, there were a handful of dutification cases.[181] In the period 2010–2016, such cases

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that defensive tactics should have "a plausible measure for maximizing shareholder wealth"); Alpert v. 28 Williams Street Corp., 473 N.E.2d 19, 28 (N.Y. 1984) (freeze-out merger must "ultimately seek to increase the individual wealth of the remaining shareholders").

178 Business Roundtable v. S.E.C., 647 F.3d 1144, 1150, 1152 (D.C. Cir. 2011).

179 Service By Air, Inc. v. Phoenix Cartage and Air Freight, LLC, 78 F.Supp.3d 852, 864 (N.D.Ill. 2015).

180 O'Bryhim v. Reliance Standard Life Ins. Co., 1999 WL 617891, at *7 (4th Cir. 1999).

181 E*TRADE Financial Corp. v. Deutsche Bank AG, 631 F.Supp.2d 313, 377 (S.D.N.Y. 2009); Rodriguez v. Loudeye Corp., 189 P.3d 168, 174-75 (Wash.App. 2008); Kreinberg v. Dow Chemical Co., 2007 WL 2782060, at *4 (E.D.Mich. 2007); Jasinover v. Rouse Co., 2004 WL 3135516, at *9 (Md.Cir.Ct. 2004).

have increased significantly, both in Delaware[182] and other jurisdictions.[183] The 2010 Delaware chancery court opinion in *eBay Domestic Holdings, Inc. v. Newmark* seems to have ushered in a new period in which courts have become comfortable with linking shareholder wealth maximization to a generalized statement of a board's obligation.[184] Notably, excepting *Revlon*-invoked cases, explicit statements about shareholder profit maximization and the conception of corporate purpose tied to the private property model of the corporation were largely absent in the prior decades.[185]

The number of dutification cases is caveated by two facts. First, all post-2009 dutification cases are trial court opinions.[186] Second, although Delaware has seen a sharp increase in dutification cases after *eBay Domestic*

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182 Virtus Capital L.P. v. Eastman Chemical Co., 2015 WL 580553, at *16 & n.5 (Del.Ch. 2015) (Laster, V.C.); In re Rural/Metro Corp. Stockholders Litigation, 102 A.3d 205, 253-53 (Del.Ch. 2014) (Laster, V.C.); Allen v. El Paso Pipeline GP Co., L.L.C., 113 A.3d 167, 179-80 (Del.Ch. 2014) (Laster, V.C.); In re Rural Metro Corp., 88 A.3d 54, 80 (Del.Ch. 2014) (Laster, V.C.); In re Orchard Enterprises, Inc. Stockholder Litigation, 88 A.3d 1, 34-36 (Del.Ch. 2014) (Laster, V.C.); In re Trados Inc. S'holder Litig., 73 A.3d 17, 20, 37 (Del.Ch. 2013) (Laster, V.C.); Feeley v. NHAOCG, LLC, 62 A.3d 649, 668 (Del.Ch. 2012) (Laster, V.C.); eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 34 (Del.Ch. 2010) (Chandler, C.).

183 IBEW Local No. 129 Ben. Fund v. Tucci, 2015 WL 9275480, at *5 (Mass.Super. 2015); Stilwell Value Partners, IV, L.P. v. Cavanaugh, 49 Misc.3d 1210(A) (N.Y.Sup. 2015); In re Gulf Fleet Holdings, Inc., 2014 WL 4560441, at *12 (W.D.La. Bankr. 2014) (citing eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 35 (Del.Ch. 2010)); Nakkhumpun v. Taylor, 2014 WL 321156, at *5 (D.Colo. 2014); In re Gulf Fleet Holdings, Inc., 491 B.R. 747, 776 (W.D.La. Bankr. 2013) (citing eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 35 (Del.Ch. 2010)); KD Gretna Properties, LLC v. Decatur Realty Corp., 2013 WL 1288048, at *5 (E.D.La. 2013); Giles v. ICG, Inc., 789 F.Supp.2d 706, 714 (S.D.W.Va. 2011); Akanthos Capital Management, LLC v. CompuCredit Holdings Corp., 770 F.Supp.2d 1315, 1333 (N.D.Ga. 2011); In re Celestica Inc. Securities Litig., 2010 WL 4159587, at *5 (S.D.N.Y. 2010); Nucor Corp. v. U.S., 675 F.Supp.2d 1340, 1348-49 (Ct. Int'l Trade 2010).

184 The specific language of profit maximization has been favorably cited. *See* OptimisCorp v. Waite, 2015 WL 5147038, at *61 n.520 (Del.Ch. 2015) (Parsons, V.C.); Vitus Capital L.P. v. Eastman Chemical Co., 2015 WL 580553, at *16 n.5 (Del.Ch. 2015) (Laster, V.C.); Allen v. El Paso Pipeline GP Co., L.L.C., 113 A.3d 167, 179 (Del.Ch. 2014) (Laster, V.C.); Quadrant Structured Products Co., Ltd. v. Vertin, 102 A.3d 155, 187 (Del.Ch. 2014) (Laster, V.C.); In re Rural Metro Corp., 102 A.3d 205, 253, (Del.Ch. 2014) (Laster, V.C.); In re Gulf Fleet Holdings, Inc., 2014 WL 4560441, at *12 (Bankr.W.D.La. 2014); In re Trados Inc. S'holder Litig., 73 A.3d 17, 36 (Del.Ch. 2013) (Laster, V.C.); Klaassen v. Allegro Dev. Corp., 2013 WL 5967028, at *11 (Del.Ch. 2013) (Laster, Ch.); In re Gulf Fleet Holdings, Inc., 491 B.R. 747, 776 (Bankr.W.D.La. 2013); Feeley v. NHAOCG, LLC, 62 A.3d 649, 668 (Del.Ch. 2012) (Laster, V.C.).

185 Not that long ago, Delaware jurists were writing that there were competing models of the corporation with different views on the purpose of the corporation. *See* Allen et al., *supra* note 148, at 1075-77; Allen, *supra* note 142, at 264-66. *See also supra* note 142. Allen, Jacobs and Strine suggested that Delaware corporate was equivocal and did not strongly embraced either the property or entity models. Allen et al., *supra* note 148, at 1078-79.

186 *See supra* notes 182-183.

Holdings, Inc. v. Newmark, all cases are attributable to a single vice chancellor.[187] However, he is not alone in the Delaware judiciary in his enthusiasm for the idea. Chief Justice Strine has written in a recent law review article that "corporate law requires directors, as a matter of their duty of loyalty, to pursue a good faith strategy to maximize profits for the stockholders."[188] Of course, it is an addition step to go from sole authoring a law review article to announcing a rule in the majority opinion of a state supreme court. Thus far, a duty to maximize profit has not been announced by the Delaware supreme court, but its chief justice saying so publicly is of course important.

IV. THE LEGAL MECHANISM OF SHAREHOLDER PRIMACY

The above empirical evidence shows that shareholder primacy is not independent of law. It has a legal foundation. In much of social interactions, law per prescription or proscription is a driving force of behavior. Yet, shareholder primacy clearly does not and cannot work doctrinally through a rule–sanction of duty. Academically *Dodge v. Ford* may be iconic, but doctrinally the case is irrelevant. It is farfetched to believe that a rarely cited, hundred year-old case from Michigan could have actually influenced business and economic history to its current state. When juxtaposed with the empirical data, the hypothesis tells a story that *Dodge v. Ford* remained dormant and ineffective for the first sixty years since its publication in 1919 only to have suddenly become prophetic in the past thirty years, though it has never been cited much outside of law review articles. This narrative of its impact does not make sense. In truth, appellate courts have not imposed a duty to maximize profit, the breach of which would subject a board to a cognizable derivative action, judicial review of substantive business decisions, and potential liability. Courts have not embraced this form of law. Therefore, a positive legal theory must answer: Is shareholder primacy law? If so, how does the law work?

A. *Defining "Norm"*

Corporate law scholarship refers to shareholder primacy as a norm, which is really a short-hand for saying that a rule–sanction framework does not exist and thus a norm must be at work. The subject of social norms has

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187 *See supra* note 182 (citing opinions written by Vice Chancellor Travis Laster).

188 Strine, *supra* note 4, at 136.

generated significant scholarship.[189] For the purpose of this article, Richard Posner provides a workable, generally accepted definition by scholars in the field:

> Laws are promulgated by public institutions, such as legislatures, regulatory agencies, and courts, after well-defined deliberative procedures, and are enforced by the police power of the state, which ultimately means by threat of violence. Norms are not necessarily promulgated at all. If they are, it is not by the state. Often a norm will result from (and crystallize) the gradual emergence of a consensus. . . . A norm is a social rule that does not depend on government for either promulgation or enforcement.[190]

There are other definitions of a norm, such as the philosophical concept of "ought" and the mathematical concept of probabilistically consistent behavior,[191] but many leading scholars in the study of law and social norms define norms as a community-prescribed behavior enforced through some means other than the threat of governmental sanction.[192]

The labeling of shareholder primacy as a norm is consistent with the above definition. Shareholder primacy is said to be a "principle,"[193] "belief system,"[194] or "ideology"[195] that has broad community support for its normative content.[196] It is not enforceable by law through statute or judicial order. Its legitimacy, it is believed, is based on a norm, originated from the persuasiveness of economic theories and policy arguments, internalized by

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189 *See, e.g.,* SOCIAL NORMS, NONLEGAL SANCTIONS, AND THE LAW (ed. Eric A. Posner, 2007); ROBERT C. ELLICKSON, ORDER WITHOUT LAW: HOW NEIGHBORS SETTLE DISPUTES (1991). Scholars have studied norms at work in commercial law. *See, e.g.,* Eisenberg, *supra* note 11; Lisa Bernstein, *Opting Out of the Legal System: Extralegal Contractual Relations in the Diamond Industry*, 21 J. LEGAL STUD. 115 (1992).

190 Richard A. Posner, *Creating and Enforcing Norms, with Special Reference to Sanctions*, 19 INT'L REV. L. & ECON. 369, 369-70 (1999).

191 Robert Cooter, *Normative Failure Theory of Law*, 82 CORNELL L. REV. 947, 954-55 (1997). *See* HART, *supra* note 10, at 44, 55 (discussing "customs" and "habits" as distinct from obligations); Green, *supra* note 12, at 517 ("Not all practice rules are obligation-imposing, however; most are just ordinary customs and conventions.").

192 *See* Cooter, *supra* note 191, at 9550; Sunstein, *supra* note 122, at 915; Oliver Hart, *Norms and the Theory of the Firm*, 149 U. PA. L. REV. 1701, 1701 (2001); Ellickson, *supra* note 123, at 3; Robert Cooter, *Do Good Laws Make Good Citizens? An Economic Analysis of Internalized Norms*, 86 VA. L. REV. 1577, 1579-80 (2000).

193 Allen et al., note 148, at 1079.

194 Matthew T. Bodie, *AOL Time Warner and the False God of Shareholder Primacy*, 31 J. CORP. L. 975, 977 (2006).

195 STOUT, *supra* note 5, at 2.

196 *See supra* notes 6 and 55 and accompanying text.

the business community and presumably enforced through non-state censure.[197] This widely-perceived account is inaccurate because it diminishes the role of courts and the centrality of law in imposing an obligation on managers. Logic alone suggests this: If corporate governance is founded on law, we should expect one of its fundamental tenets to be founded on the law and the legal system. Experience confirms this: Courts have embraced shareholder primacy over a thirty-year period. This fact is not without legal effect. Shareholder primacy is not just a norm, such as taking off one's hat in a house of worship or rising for the national anthem, conduct that are widely observed, not because of a legal obligation, but because of social pressure and internalization of custom. Shareholder primacy ultimately derives its legitimacy from judicial acceptance and the obligation it creates demands compliance.

The missing idea in a positive legal theory of shareholder primacy is that law can be expressed by the government as an obligation without formal sanction if the application of such police power would undermine other important rules and a sanction is not needed to achieve efficacy of the law's prescription.

B. *Shareholder Primacy as Obligation*

Shareholder primacy is not a legal duty, but is instead a legal obligation.[198] H.L.A. Hart's *The Concept of Law* provides an insight into obligations that rise to law. In theorizing the jurisprudential question "what is law?" he critiqued Austin's idea of law as a general command backed by the coercive force of the threat of government.[199] Austinian form of law aptly describes fields such as criminal law, torts, and regulated industries, which are constructed on the idea of duty, breach, and sanction.[200] Fiduciary duties of corporate managers, being liability rules, are also in this form of duty-based rules enforceable through sanction.[201]

However, some laws are not in Austinian form. A law can be either unenforceable or simply enabling. A particularly relevant example in the field of business organizations is laws that "confer legal powers on private

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197 *See supra* note 55 and accompanying text.

198 *See supra* notes 12-14 and accompanying text.

199 HART, *supra* note 10, at 18-25. *See* Green, *supra* note 12, at 517 ("sanction theories are now nearly friendless").

200 *Id.* at 27.

201 *See supra* note 36.

individuals."[202] Corporate law is said to be enabling, characterized in large parts by its power to enable a set of privately ordered legal and economic relationships among corporate constituents.[203] Thus, the Austinian concept of law does not fully describe other forms of law.[204]

A rule imposes an obligation when the general demand for conformity is insistent and the social pressure brought to bear upon those who deviate is great.[205] Social customs and obligations differ on the degree of social pressure: "What is important is that the insistence on importance or *seriousness* of social pressure behind the rules is the primary factor determining whether they are thought of as giving rise to obligations."[206] An obligation is supported not only by a general demand for compliance and social pressure, but also such demand for compliance is considered a legitimate response to deviations.[207] An obligation is mandatory, which distinguishes it from other norms.[208]

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202 HART, *supra* note 10, at 28. These laws include contracts, wills, and marriages. *Id.* at 27. They also include the laws of non-corporate entities that provide greater contractual flexibility than the corporate form. *See, e.g.*, DEL. CODE ANN. tit. 6, § 18-1101(b) ("It is the policy of this chapter to give the maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements."). *See also* LARRY E. RIBSTEIN, THE RISE OF THE UNCORPORATION 37 (2010) (suggesting that LLCs "have real contracts" unlike corporations).

203 Shintom Co., Ltd. v. Audiovox Corp., 888 A.2d 225, 227 (Del. 2005); Williams v. Geier, 671 A.2d 1368, 1381 (Del. 1996); William T. Allen, *Contracts and Communities in Corporation Law*, 50 WASH. & LEE L. REV. 1395, 1400 (1993). The idea of enabling contractual relationship in a firm is seen in economic theories of the firm, which formed the basic ideas of law and economic conception of corporate law. *See* R. H. Coase, *The Nature of the Firm*, 4 ECONOMICA 386 (1937); Eugene F. Fama, *Agency Problems and the Theory of the Firm*, 88 J. POL. ECON. 288, 290 (1980).

204 HART, *supra* note 10, at 79-81.

205 *Id*. at 86-87. Other scholars have been influenced by Hart's idea of an effective obligation. *See* Cooter, *supra* note 191, at 955 & n.45.

206 HART, *supra* note 10, at 87 (emphasis in original).

207 H.L.A. Hart, *Answers to Eight Questions*, in READING HLA HART'S THE CONCEPT OF LAW 283 (Luis Duarte D'Almeida ed., 2013). "What is necessary is that there should be a critical reflective attitude to certain patterns of behaviour as a common standard, and that this should display itself in criticism (including self-criticism), demands for conformity, and in acknowledgments that such criticism and demands are justified, all of which find their characteristic expression in the normative terminology of 'ought', 'must', and 'should', 'right' and 'wrong'." HART, *supra* note 10, at 57. *See id.* at 90 ("the violation of a rule is not merely a basis for the prediction that a hostile reaction will follow but a reason for the hostility").

208 Kenneth Einar Himma, *A Comprehensive Hartian Theory of Legal Obligation: Social Pressure, Coercive Enforcement, and the Legal Obligation of Citizens*, in PHILOSOPHICAL FOUNDATIONS OF THE NATURE OF LAW, at 162, 166 (eds. Wil Waluchow & Stefan Sciaraffa, 2013). *See* Sunstein, *supra* note 123, at 914 (describing Hart's concept of legal obligations as a subclass of norms).

In a legal system, the government, such as the judiciary, applies rules of recognition to determine obligations, such as when common law courts determine the rule of law. A court may observe general characteristics possessed by an obligation and its "relation to judicial decisions."[209] Courts do not always state the rule applied to recognize an obligation, but instead it is frequently shown in the decision: thus, "when courts reach a particular conclusion on the footing that a particular rule has been correctly identified as law, what they say has a special authoritative status conferred on it by other rules."[210] The identification of a rule in the legal system validates the obligation.[211] Validity of a rule differs from its efficacy.[212] If law is more than the Austinian concept, it requires a dissociation of validity from efficacy because an obligation may not always be sanctionable and thus enforced.[213] However, the internalization of a rule as a legal obligation presuppose the truth of a legal system that is "generally efficacious."[214]

Shareholder primacy is more than a social custom or social norm. It is a legal obligation in the Hartian tradition: it is an important rule imbued with a "seriousness of social pressure" though it is not enforceable; it is recognized and institutionalized by courts; it is said to be foundational to corporate law and governance. The reprobation directed at one who deviates from the rule would be considered legitimate. This social pressure may be inconsistent at times with the corporate manager's own value system, but nevertheless she may feel compelled to obey the rule.[215] Thus, outlier cases like *Dodge v. Ford* and *eBay v. Newmark* are insubstantial at the instrumental level of doctrine;[216] their significance is at the expressive level.

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209 HART, *supra* note 10, at 95.

210 *Id.* at 101-02.

211 *Id.* at 103. *See* Roscoe E. Hill, *Legal Validity and Legal Obligation*, 80 YALE L.J. 47, 51 (1970) ("In Hart's system, therefore, a legal rule of obligation (imposing legal obligation) is created whenever the relevant officials make the appropriate manipulations under the secondary rules of the legal system.").

212 HART, *supra* note 10, at 103.

213 *d.* at 217-18.

214 *Id.* at 103-04.

215 Hart adds two other characteristics of an obligation: (1) the obligation is thought to be important "because they are believed to be necessary to the maintenance of social life or some highly prized feature of it"; (2) the obligation, while benefiting others, may "conflict with what the person who owes the duty may wish to do" and thus it is "thought of as characteristically involving sacrifice or renunciation." *Id.* at 87. *See* Green, *supra* note 12, at 517. In this sense, an obligation demands compliance. *See supra* note 208.

216 As categorized in the empirical analysis here, these cases are the "application" cases. *See supra* note 155 and accompanying text. The courts applied the concept of

They legitimize shareholder primacy through a judicial rebuke of perceived deviations from a legal obligation.[217] The opinions are consistent with the large body of judicial literature across many jurisdictions and over several decades. Furthermore, the recent rise of dutification cases in lower court opinions are not a signal of a move toward an enforceable duty.[218] Instead, they unambiguously express the judicial expectation of the obligation. They function at the level of expressive value.[219] The rule of law, not social norm, has resulted in today's strongly shareholder-centric economic orientation in corporate governance.

Shareholder primacy also has both external and internal aspects. The volume of judicial literature over several decades clearly show that courts have recognized shareholder primacy. Courts accept arguments based on shareholder primacy; they embrace the concept as a part of the reasoning process toward judicial outcomes; they incorporate the concept in other principles and rules of corporate law. The rule of shareholder primacy is not simply a pronouncement by a few courts or even important courts such as Delaware's. In this sense, it is not simply the occasional dictum of judicial rumination on best practices, which would not rise to the level of a rule of law. Instead, courts have embraced the obligation pervasively, across many jurisdictions, and over several decades. The weight and seriousness of the concept is apparent. These collective judicial actions have recognized a legal obligation. This obligation has been internalized by managers and shareholders.[220] Courts have directed this internalization by focusing the business community toward a single common objective. [221]

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shareholder primacy in the process of reasoning toward the case holding with respect to the distribution of dividends and the application of a poison pill defense.

217 Ford's honest confession of an altruistic motive earned the court's rebuke. *See* Strine, *supra* note 4, at 148; Macey, *supra* note 8, at 183.

218 *See supra* Section III.C. & Chart 5.

219 *See* Richard H. McAdams, *A Focal Point Theory of Expressive Law*, 86 VA. L. REV. 1649, 1650-51 & n.2 (2000) ("The thesis is that law influences behavior independent of the sanctions it threatens to impose, that law works by what it says in addition to what it does."); Sunstein, *supra* note 123, at 964 ("Many laws have an expressive function. They 'make a statement' about how much, and how, a good or bad should be valued. They are an effort to constitute and to affect social meanings, social norms, and social roles.").

220 *See supra* Sections III.B. and III.C.

221 "[L]aw facilitates coordination by making a particular outcome salient; law's requirements focus individuals' attention on one way to coordinate, channeling their behavior in that direction." RICHARD H. MCADAMS, THE EXPRESSIVE POWERS OF LAW 22 (2015). Coordination to a single objective is consistent with agency cost theory of the firm, which says that an agent must be given a single objective, lest the agent will pursue his own interest and agency cost will increase. Jensen, *supra* note 48, at 238; EASTERBROOK & FISCHEL, *supra* note 51, at 38. Thus, shareholder primacy can be seen as a legal focal point that coordinates the behavior of managers toward a single goal.

Enforceability is not a precondition of efficacy. Unenforceability does not inevitably result in inefficacy, and thus perhaps delegitimization. Most commentators, including critics, conclude that shareholder primacy has been internalized by a consensus of all relevant constituents.[222] This fact predicts significant compliance without the need for enforcement. Not all laws are coupled with a meaningful sanction.[223] Examples from other laws show that law may work through expressive value.[224] This is not to suggest that regulatory rules without sanctions are a standard form of law. Most regulations work through enforcement. Although much of corporate law enables the private ordering of economic actors,[225] shareholder primacy—to the extent that it prescribes managerial behavior through a rule of law—is regulatory in character.[226] However, shareholder primacy cannot take the form of a rule–sanction because the structure of corporate law would become internally incoherent.[227] And, efficacy does not require this form of law. A rule–no sanction form is seen in law when a rule can still achieve compliance through other means.[228]

C. *Complete Shareholder Primacy*

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222 *See supra* note 6.

223 States have legislated a duty to rescue, which is contrary to the common law of torts, but the sanctions are so light that these laws are best understood as having an expressive function. *See* MINN. STAT. ANN. § 604A.01(1); VT. STAT. ANN., tit. 12, § 519; WISC. STAT. § 940.34. There are laws against cursing in public with *de minimis* penalties. *See* MICH. COMP. L. ANN. § 750.103; R.I. GEN. L. § 11-11-5. Federal statute prohibits disrespect of the flag, but provides no penalty. 4 U.S.C. § 8(h). The field of international law must generally contend with obligations without sanctions. *See generally* Kenneth W. Abbott & Duncan Snidal, *Hard and Soft Law in International Governance*, 54 INTERNATIONAL ORGANIZATION 421 (2000); Andrew T. Guzman & Timothy L. Meyer, *International Soft Law*, 2 J. LEGAL ANALYSIS 171 (2010).

224 *See supra* note 219.

225 *See supra* note 203.

226 On this point, there is apparent tension in corporate law. Statutory corporate law is enabling in that it allows a corporation to pursue any lawful activity. *See supra* notes 19 & 203. However, case law is regulatory in that shareholder primacy obligates managers through law to pursue profit maximization. This tension is resolved if the statute is read as prohibiting a corporation from pursuing unlawful activities. *See* In re Massey Energy Co., 2011 WL 2176479 (Del.Ch. 2011). Assuming that the corporation's activity is lawful, the corporation has an obligation under case law to maximize profit. Corporate law is regulatory in this respect.

227 *See supra* Section I.B.

228 Leslie Green, *Introduction*, HART, *supra* note 10, at xxx.

Court have imposed the obligation of shareholder primacy on the entire spectrum of managerial decisions. Although this obligation is unenforceable, it exerts serious social pressure to comply. But we are still left with the question: How exactly is the pressure applied since an unenforceable rule can be seen as a paper tiger? Why do managers obey a rule that cannot be enforced against them?

We start with the basic premise: Shareholder primacy and primacy of managerial authority cannot coexist in a rule–sanction form. The legal mechanism of shareholder primacy must solve a doctrinal puzzle: (1) the primacy of managerial authority is a rule–sanction, and as such it is a first order rule in that it has independent dignity; (2) shareholder primacy is a rule–no sanction, and as such it is a second order rule in that it is subordinate to any first order rule at the level of enforcement; (3) however, the purpose of the first order rule is to serve the second order rule at the level of prescription and substantive content, and as such the latter must be efficacious in spite of the former. When the doctrinal and jurisprudential problem is framed in this way, we see why the legal status of shareholder primacy has been opaque for so long.[229]

As a matter of practice and theory, the law of shareholder primacy only works as a coupling of first order and second order rules. The legal mechanism of shareholder primacy resolves the tension between the two rules. It enables the second order rule to exert a conditional obligation on the first order rule and do so efficaciously.[230] Compliance without sanction achieves two important functions: it is efficient because there are no additional litigation costs; and, it preserves the rule of managerial authority and thus the coherence of the basic structure of corporate law.

The law and the legal system writ large achieve broad compliance through the following pathways: legitimacy of obligation, positive and negative incentives on managers, litigation risk imposed on managers, and social norm in the business community.

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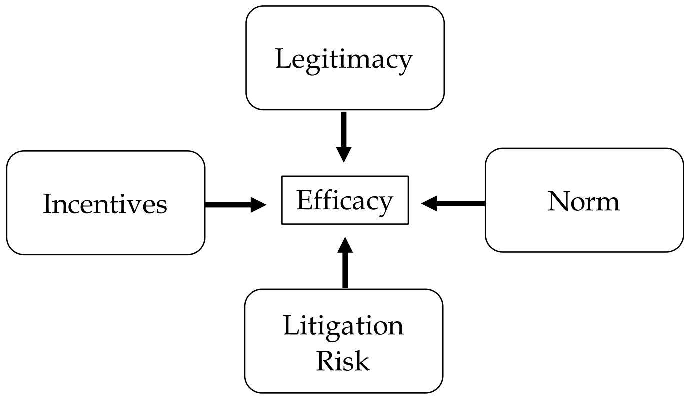
[229] *See supra* Section I.

[230] *See supra* note 6 and Section III.A.

Figure 2: Complete Shareholder Primacy



First, corporate law and the legal system advance shareholder primacy as a legal obligation through positive and negative incentives inherent in performance-based executive compensation and the market for corporate control, as well the imposition of duties toward shareholders in the *Revlon* zone and inter-security conflicts.[231] The combination of these laws partially, but substantially, motivate managers to comply with shareholder wealth maximization.

Second, empirical evidence shows that courts have pervasively and over a long period embraced shareholder primacy. Courts have used the concept of shareholder wealth maximization both at the factual and legal levels of analysis.[232] This judicial embrace has legitimized shareholder primacy and given it the cloak of legal authority.

Third, judicial recognition of an obligation creates legal uncertainty and litigation risk for corporate managers. The incentive, then, is to comply with the rule even though the obligation cannot be enforced as an independent duty. Courts weigh whether a manager has complied with shareholder primacy in the analysis of whether other rules were violated or not. Under this consideration, compliance is simply the path of least resistance given the negative incentives. The grant of fiduciary duty only to shareholder ensures that only unsatisfied shareholders can bring a derivative suit against managers when they fail to maximize profit.

Fourth, obligations can legitimize and strengthen norms. This institutionalization of a social rule through a judicially announced

231 *Supra* Section II.
232 *Supra* Section III.

obligation is critical to the need to obey and actual compliance.[233] Courts have validated the normative policy rationale for shareholder primacy held by the academic, policy, and business communities. Thus, alongside the legal obligation, there is a norm in the community, and its strength is measured by the degree of compliance with the principle of wealth maximization even if there is little risk of a sanction for business decisions falling within the business judgment rule.

When these four factors are considered in totality, the legal mechanism of shareholder primacy is clear and complete. Corporate law achieves a harmonization of the first order and second order rules with dual efficacy. A board manages the business and affairs of the corporation, and she has vast discretion under the business judgment rule to consider the balance of interests among shareholders and other constituents.[234] The primacy of managerial authority is enforceable in court, and courts frequently enforce it in favor of management when shareholders seek to encroach upon board's authority.[235] Such enforcements in favor of management and against shareholders is unremarkable. However, managerial behavior and actions are nonetheless steered toward shareholder interest through multiple rules, incentives, and justifications provided by courts and the legal system.

The realm of all management decisions can be broadly categorized into decisions relating to takeovers, financing, and operational decisions of a going concern. In takeovers and financings, *Revlon* and inter-security priority doctrines enforce shareholder primacy in the form of rule–sanction.[236] Because these transactions typically involve significant monies, the chance of avoiding detection and escaping judicial review are slim. The threat of sanction is direct and real, which applies negative incentives.

Takeovers and financings, however, are specific transactions. The vast

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233 Leslie Green argues that an account of obedience to law is grounded in part on the law's institutionalization.

> First, law is *institutionalized*: it is the product not only of human thought and action and in that sense a social construction; it is more significantly the product of institutionalized thought and action. Nothing is law that is not in some way connected with the activities of institutions such as legislatures, courts, administrators, police, and so on. Neither ideal social norms nor general social customs, but only an institutionally relevant subset of these, count as law.

Green, *supra* note 12, at 523. *See* HART, *supra* note 10, at 103.

234 *See supra* notes 33, 40 & 41 and accompanying text.

235 *See supra* notes 40-46 and accompanying text.

236 *See supra* Sections II.A. and II.B.

majority managerial decisions are operational decisions made in the context of a going concern. In this realm, managers have great discretion under the first order rule of managerial authority to comply with the obligation of shareholder primacy or not, depending on their preference or values (the classic agency cost theory in corporate law). They are generally safe from sanction since there is no enforceable duty. However, there are many non-sanction checks arising from law that constrain a manager's virtually unfettered discretion under the first order rule. The legal system provides corporate manager's carrot-and-stick incentives. Executive compensation and the market for corporate control provide complementary incentives and align shareholder and manager economic interests. In light of normative arguments and the business community's acceptance of them, the path of least resistance—paved by courts—is also the internalized norm of most managers.[237] These combined factors push managers toward compliance with the rule of law.[238]

Although there is no duty to maximize profit, the threat of real sanction exists, albeit indirectly. Managers understand that *other rules* of corporate law exist in a rule–sanction form. Those rules are connected to the principle of shareholder primacy. For example, *Revlon* applies only in a change of control context, but the context may be open-textured and the precise geography of *Revlon* remains uncertain. In any takeover transaction where a change of control is arguable, corporate managers are incentivized to maximize shareholder profit. The decisions in *Dodge v. Ford* and *eBay Domestic Holdings, Inc. v. Newmark* are prime examples of indirect sanction through other enforceable rules (*viz*. rules on dividend distributions and takeover defenses), since it is clear in both cases that the court rebuked the controlling shareholders' rejection of the profit motive.[239]

Courts have applied and integrated the concept to the legal reasoning process and rule justification.[240] It would be reasonably apparent to a board, typically advised by sophisticated corporate lawyers, that shareholder primacy may be a factor in the liability determination of these rules. When the boundaries of a rule is uncertain and the law is applied in an open-

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237 *See* Rock, *supra* note 72, at 1988 ("Managers now largely think and act like shareholders.").

238 *See generally* LAWRENCE M. FRIEDMAN, IMPACT: HOW LAW AFFECTS BEHAVIOR 5, 96-217 (2016) (arguing that law affects behavior through three principal factors: positive and negative incentives, peer pressure, and internalization of rules).

239 *See supra* note 216; Bernard S. Sharfman, *Shareholder Wealth Maximization and Its Implementation under Corporate Law*, 66 FLA. L. REV. 389, 425-30 (2014).

240 *See supra* Section III.C.

ended and potentially ex ante indeterminate,[241] law and economic literature has shown that the uncertainty can lead to over-compliance as parties may be incentivized to take additional precautions.[242] Thus, there is always the threat of indirect liability even though the legal form is a second order rule.

Finally, to understand the role of courts in creating the obligation of shareholder wealth maximization, consider this counterfactual: What if, over the period 1980–2016, courts had pervasively rejected or softened the idea of shareholder primacy? This alternative world is not so farfetched. In the landmark case *Burwell v. Hobby Lobby Stores, Inc*., the majority Supreme Court claimed that while "it is certainly true that a central objective of for-profit corporations is to make money, modern corporate law does not require for-profit corporations to pursue profit at the expense of everything else, and many do not do so."[243] Of course, it is not too cynical to believe that this liberal-sounding statement was an instrumental rationale, unique to the case and the issue of corporate religious liberty at hand.[244] But in a counterfactual world, what if courts across the land had consistently admonished shareholders and managers that "modern corporate law does not require for-profit corporations to pursue profit at the expense of

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241 Delaware law is contextual and open-ended, and thus indeterminate in outcomes. *See* Hansmann & Kraakman, *supra* note 6, at 459; Mohsen Manesh, *Delaware and the Market for LLC Law: A Theory of Contractibility and Legal Indeterminacy*, 52 B.C. L. REV. 189, 224 (2011); William J. Carney & George B. Shepherd, *The Mystery of Delaware Law's Continuing Success*, 2009 U. ILL. L. REV. 1, 29 (2009).

242 *See* Richard Craswell & John E. Calfee, *Deterrence and Uncertain Legal Standards*, 2 J.L. ECON. & ORG. 279, 280 (1986); John E. Calfee & Richard Craswell, *Some Effects of Uncertainty on Compliance with Legal Standards*, 70 VA. L. REV. 965, 965 (1984). If uncertainty is distributed normally around the optimal standard of care, the legal rule will have an over-deterrence effect because a cost-benefit analysis may militate taking more precaution at the margin to comply. Robert J. Rhee, *On Duopoly and Compensation Games in the Credit Rating Industry*, 108 NW. U. L. REV. 85, 132 (2013).

243 134 S.Ct. 2751, 2771 (2014).

244 The Supreme Court has been trending toward a pro-business bias for several decades. Lee Epstein, William M. Landes & Richard A. Posner, *How Business Fares in the Supreme Court*, 97 MINN. L. REV. 1431, 1450, 1470-71 (2013). From the perspective of corporate law, the above quoted language in *Hobby Lobby* sounds liberal in its rejection of a singular profit motive, but the case is unquestionably a pro-business decision because it expands corporate personhood and rights. All five Justices in the majority (Alito, Roberts, Scalia, Kennedy, and Thomas) are ranked in the top 10 pro-business Supreme Court justices for the period 1946–2011, and the opinion author (Alito) is ranked first in this list followed by Roberts who is second. *Id*. at 1450. *Citizens United* and *Hobby Lobby* challenge the traditional "conservative theory" of corporation law based on profit maximization. Leo E. Strine & Nicholas Walter, *Conservative Collision Court?: The Tension Between Conservative Corproate Law Theory and* Citizens United, 100 CORNELL L. REV. 335, 336-38 (2015). The two cases also challenge conventional concept of corporate separateness. *Amicus Curiae* Brief of Corporate and Criminal Law Professors in Support of Petitions in *Sebelius v. Hobby Lobby Stores, Inc*. at 3-13 (Jan. 2014).

everything else" and had reasoned through and decided cases based on this principle? There would not have been a legal obligation to maximize profit. Corporate governance and perceptions of legal obligations are products of corporate law, and courts have the power to create or validate a rule of law. Since law can legitimize or delegitimize social norms, there would not even have been a strong norm in the business community. Instead, there would have been only schools of intellectual thought in the academic community.

CONCLUSION

Shareholder primacy is law, and not just a social norm. Case law since the 1980s shows that courts have embraced the concept. The legal mechanism of shareholder primacy is not a single locus rule–sanction form. It is in the form of a legal obligation. Courts have legitimized and imposed the obligation to maximize shareholder profit across the entire spectrum of managerial decisionmaking. The principle weaves through a series of corporate law rules and the architecture of the corporate and market systems. A legal obligation is the only form of law that is coherent in light of the primacy of managerial authority. By legitimizing shareholder primacy without creating a duty, the law harmonizes the conflict between authority and accountability.

The legal mechanism that begets and advances the idea of shareholder wealth maximization is complex, efficacious, and efficient. It is complex because it must harmonize the coupling of first order and second order rules that is unique to corporate law while respecting the independent dignity of both rules. It is efficacious because the rule of law has been internalized without the coercion of sanctions. It is efficient because the rule achieves compliance at systematic, predictable levels at minimal cost. Whether the rule is socially efficient, equitable, or ethical—all contestable points—is in the domain of a normative theory. However, the normative debate and policy prescription must be informed by a positive theory of law. Whether law exists or not matters. The cause and effect of shareholder primacy rests on a legal foundation, and not some general notion of collective social belief that perhaps can change with enough suasion or argument. Any policy prescription from a normative theory must address the fact that there is a law of shareholder primacy.