ESSAY

THE CORPORATE GOVERNANCE MACHINE

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The conventional view of corporate governance is that it is a neutral set of processes and practices that govern how a company is managed. We demonstrate that this view is profoundly mistaken: For public companies in the United States, corporate governance has become a "system" composed of an array of institutional players, with a powerful shareholderist orientation. Our original account of this "corporate governance machine" generates insights about the past, present, and future of corporate governance. As for the past, we show how the concept of corporate governance developed alongside the shareholder primacy movement. This relationship is reflected in the common refrain of "good governance" that pervades contemporary discourse and the maturation of corporate governance as an industry oriented toward serving shareholders and their interests. As for the present, our analysis explains why the corporate social responsibility movement transformed into shareholder value–oriented environmental, social, and governance (ESG) standards, stakeholder capitalism became relegated to a new separate form of entity known as the benefit corporation, and public company boards of directors became homogenized across industries. As for the future, our analysis suggests that absent a major paradigm shift that would force multiple institutional gatekeepers to switch their orientation, advocacy pushing corporations to consider the interests of employees, communities, and the environment will likely fail unless such effort is framed as advancing shareholder interests.

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** Professor of Law, University of Pennsylvania Law School. We thank Steve Bainbridge, Bill Bratton, Chris Brummer, Christopher Bruner, Jill Fisch, Stavros Gadinis, Zohar Goshen, Keir Gumbs, Chris Havasy, Don Herzog, Virginia Harper Ho, Nico Howson, Sue Konzelmann, Da Lin, Ann Lipton, Amelia Miazad, Peter Molk, Gaizka Ormazabal, Mariana Pargendler, Bob Rasmussen, Rob Rhee, Sergio Gramitto Ricci, Wolf-Georg Ringe, Danny Sokol, Leo E. Strine, Jr., Avi Weiss, Andrew Winden, and workshop participants at the Organizations and Social Impact Workshop at Berkeley Law, Foundations of Law and Finance Research Seminar at Goethe University-Frankfurt, Corporate and Securities Law in Society Workshop, University of Florida Levin College of Law, Fordham University School of Law, Corporate Law Academic Webinar Series (CLAWS), LSE-UCL Law and Finance Seminar, University of Texas Business Law and Economics Workshop, Oxford Law and Business Workshop, ECGI and Yale Global Corporate Governance Colloquium, National Business Law Scholars Conference, Wharton Legal Studies & Business Ethics Workshop, and University of Richmond School of Law. We also thank Hayk Badalyan and QC Vu for excellent research assistance.

INTRODUCTION

In a time of climate change, racial and economic inequality, and crisis stemming from the global pandemic, corporations are alternately maligned for their conduct and embraced as a solution for change. Observers have increasingly excoriated the traditional view of corporate purpose—that corporations should be managed for the benefit of shareholders and, specifically, to maximize shareholder wealth—as contributing to societal problems.[1] Spurred by this debate, and only two decades after prominent scholars announced "the end of history" in favor of shareholder primacy,[2] luminaries in the field are again asking these central questions of corporate law: For whom is the corporation managed?[3] Do fiduciaries owe a duty to maximize shareholder value or may they prioritize the interests of other stakeholders?

We contribute to this important debate by enlarging the aperture. Specifically, we provide an original descriptive account of the "corporate governance machine"—a complex governance system in the United States composed of law, institutions, and culture that orients corporate decisionmaking toward shareholders. We describe the key players in the system and show how the machine powerfully drives corporate behavior and influences corporate regulation.

In so doing, we make three primary contributions. First, we provide a holistic account of the contemporary U.S. corporate governance infrastructure and show how it solidifies corporate purpose as promoting shareholder interests. Although legal academics have generally focused on corporate law as a key determinant of purpose, our analysis reveals that this element may well be the least important: A vast array of institutional players—proxy advisors, stock exchanges, ratings agencies, institutional

1. See, e.g., Colin Mayer, Prosperity: Better Business Makes the Greater Good 31–45 (2018) (arguing that shareholder wealth maximization is a fundamentally flawed understanding of corporate purpose).

2. Henry Hansmann & Reinier Kraakman, The End of History for Corporate Law, 89 Geo. L.J. 439, 440–42 (2001). Scholars have used the term "shareholder primacy" to refer to two different concepts, reflecting the ends and means or purpose and power of corporations: (1) that corporations are, or should be, managed in the interests of shareholders; and (2) that shareholders have, or should have, ultimate control over the corporation. Stephen M. Bainbridge, Director Primacy: The Means and Ends of Corporate Governance, 97 Nw. U. L. Rev. 547, 573 (2003) [hereinafter Bainbridge, Director Primacy]; Robert B. Thompson, Anti-Primacy: Sharing Power in American Corporations, 71 Bus. Law. 381, 387–88 (2016) [hereinafter Thompson, Anti-Primacy]. We primarily use the term descriptively in the first sense.

3. For a sampling of this literature, see generally Lucian A. Bebchuk & Roberto Tallarita, The Illusory Promise of Stakeholder Governance, 106 Cornell L. Rev. 91 (2020); Jill E. Fisch & Steven Davidoff Solomon, Should Corporations Have a Purpose?, 99 Tex. L. Rev. 1309 (2021); Edward B. Rock, For Whom Is the Corporation Managed in 2020? The Debate Over Corporate Purpose, 76 Bus. Law. 363 (2021) [hereinafter Rock, Debate Over Corporate Purpose].

investors, and associations—enshrine shareholder primacy in public markets.[4] Indeed, we show the very concept of corporate governance promoted by these players developed alongside the principal-agent model of the corporation, such that "good governance" is often equated with minimizing agency costs in the pursuit of shareholder value.[5] Professional education, the media, and politics further reinforce this cultural understanding.[6]

We also explore examples that demonstrate the machine's influence over important aspects of public company governance. Corporate social responsibility, for example, was once framed in moral terms as a goal for management irrespective of profit.[7] But after several decades of circulation within the machine, the idea of corporate social responsibility has been largely replaced with investor-driven environmental, social, and governance (ESG). Today many companies pursue ESG goals, and many investors favor ESG funds, not for moral reasons or a prosocial willingness to sacrifice profits, but because ESG is thought to provide sustainable long-term value or higher risk-adjusted returns for shareholders.[8] This reframing has in turn shaped managerial decisionmaking about the kinds of ESG activity in which corporations should engage. As the corporate governance machine transformed corporate social responsibility into value-enhancing ESG, it has also pushed social purpose beyond this framing into an entirely different form of corporation—the benefit corporation—which we show is also driven by shareholders and their values.[9]

Second, we look to the consequences of the corporate governance machine's workings and posit that its shareholderist orientation is potentially suboptimal. When shareholderism is locked into rules, norms, and power structures, superior governance arrangements from a social welfare perspective may be discouraged or taken off the table.[10] From convergence on one-size-fits-all governance "best practices" to reduced corporate governance innovation, we identify a range of negative implications for corporate law and governance wrought by this system.[11]

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4. See infra Part II.

5. See infra Part I.

6. See infra section II.C.

7. See infra section I.B.

8. See infra notes 216–226 and accompanying text.

9. See infra section III.C.

10. See Mark J. Roe, Chaos and Evolution in Law and Economics, 109 Harv. L. Rev. 641, 648 (1996) [hereinafter Roe, Chaos and Evolution] (explaining how path dependence can "permit structures that were once satisfactory to become inefficient but not be worth changing" due to the high costs of switching).

11. See infra Part IV. The resulting lack of diversity in governance might fall short of the expectations of contractarian scholars as well as those who recognize that network benefits can accrue from common use and advocate for a menu approach to corporate law. See Frank H. Easterbrook & Daniel R. Fischel, The Economic Structure of Corporate Law 5, 34 (1991) [hereinafter Easterbrook & Fischel, Economic Structure of Corporate Law] (stating that "[n]o set of promises is right for all firms" and arguing that corporate law's purpose is

Third, and finally, this "meta" account of the U.S. corporate governance system elucidates much about the path of corporate governance reform and the success of the stakeholder governance movement in particular. At the outset, we show how over the past several decades, law, institutions, and culture have entrenched a shareholder-oriented view in corporate law and governance. Battles over the allocation of power within the corporation occur on policy issues such as proxy access and shareholder proposals, but the larger war has been won. We predict that legal reform and soft law standards will continue to be filtered through this lens, and stakeholder-oriented reforms that are framed as benefitting shareholders will have a chance of survival and indeed, be increasingly embraced. As evidence, recall that the ESG movement took off when it was framed in terms of shareholder value. Consider, too, the evolution in corporate purpose away from share price maximization and toward "long-term shareholder value" or even "shareholder welfare" maximization.[12] In many ways, these developments soften the hard edges of shareholder primacy, but this evolution is itself a legacy of the corporate governance machine: Those who wish to change corporate decisionmaking are forced to do so within the bounds of shareholderism.

What does this mean for the future of corporate governance? On the one hand, absent a large shock to the system, such as a major federal intervention that would force multiple institutional gatekeepers to change their orientation,[13] the corporate governance machine will likely impede

to provide efficient default rules that can be customized); Michael Klausner, The Contractarian Theory of Corporate Law: A Generation Later, 31 J. Corp. L. 779, 797 (2006) ("Corporate law can . . . promote innovation and customization by providing menus of alternative governance structures that firms can adopt in standardized form by designating in their charters that they choose to do so.").

12. See Jesse M. Fried, The Uneasy Case for Favoring Long-Term Shareholders, 124 Yale L.J. 1554, 1565 (2015) (observing that "as a matter of economic theory, the effect of managers' time horizons (that is, whether managers serve short-term or long-term shareholders) on stakeholder welfare is actually indeterminate"); Frank Partnoy, Specificity and Time Horizons, 41 Seattle U. L. Rev. 525, 533 (2018) (arguing that stakeholder advocates should articulate an optimal time horizon for firm managers to use, as well as the grounds for concluding it is optimal); see also Virginia Harper Ho, "Enlightened Shareholder Value": Corporate Governance Beyond the Shareholder-Stakeholder Divide, 36 J. Corp. L. 59, 62 (2010) [hereinafter Harper Ho, Enlightened Shareholder Value] (discussing the concept of "enlightened shareholder value" that views attention to stakeholder interests "as a means of generating long-term shareholder wealth and improving portfolio- and firm-level risk assessment"); Ann M. Lipton, What We Talk About When We Talk About Shareholder Primacy, 69 Case W. Rsrv. L. Rev. 863, 866–67 (2019) [hereinafter Lipton, Shareholder Primacy] (discussing how most scholarly discourse equates shareholder primacy with wealth maximization, but recent literature has described it in terms of welfare or values that shareholders determine for themselves).

13. Although the COVID-19 pandemic could prove a catalyst, the emerging consensus is that it will not likely result in sweeping change to corporate and securities law. See, e.g., Steven A. Bank & Brian R. Cheffins, Corporate Law's Critical Junctures, Bus. Law. (forthcoming) (manuscript at 72–76), https://ssrn.com/abstract=3877329 [https://perma.cc/K8YJ-Z5BN] ("[W]hile the possibility that corporate America will

a true paradigm shift away from shareholderism. On the other hand, our account reveals how incremental change could take place. As shifts in understanding regarding the merits of various ESG initiatives occur through cultural and market forces, the promotion of stakeholder interests can be reconciled with pursuing long-term shareholder value. For example, institutional investors and asset managers that hold diversified portfolios increasingly recognize the financial benefits of mitigating climate change risk.[14] Likewise, corporate sustainability initiatives can protect undiversified investors against downside risk.[15] To the extent that ESG metrics become easier to measure and disclose, more of such activity might occur and a greater number of investors might support it. Notably, however, this future change is likely to occur through the existing shareholderist model, which limits acceptable rationales and favors activity that can be reduced to measurable metrics tied to risk or financial value.[16]

Part I traces the historical and intellectual underpinnings of corporate governance and charts its rise alongside the shareholder primacy movement. Part II provides an original descriptive account of the U.S. system of corporate governance and its components, showing how law, institutions, and culture enmesh shareholderism at public corporations. Part III explores how the corporate governance machine works using three examples. It describes how the machine has transformed public company boards, shaped the shift from corporate social responsibility to investor-driven ESG, and led to the development of a new form of business organization—the benefit corporation. Part IV examines the broader implications of this analysis for the debate about corporate purpose and other pressing debates in corporate law. It concludes with predictions about the future of corporate governance.

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ultimately suffer a reputational black eye due to the COVID-19 pandemic cannot be discounted, as matters stand the culpability that has accompanied previous corporate law critical junctures is absent.").

14. Madison Condon, Externalities and the Common Owner, 95 Wash. L. Rev. 1, 6 (2020); Jeffrey N. Gordon, Systematic Stewardship 3–5, 24 (Eur. Corp. Governance Inst., Law Working Paper No. 566/2021, 2021), https://ssrn.com/abstract=3782814 [https://perma.cc/4LHL-JT8A] [hereinafter Gordon, Systematic Stewardship].

15. Stavros Gadinis & Amelia Miazad, Corporate Law and Social Risk, 73 Vand. L. Rev. 1401, 1410 (2020); Leo E. Strine, Jr., Kirby M. Smith & Reilly S. Steel, *Caremark* and ESG, Perfect Together: A Practical Approach to Implementing an Integrated, Efficient, and Effective *Caremark* and EESG Strategy, 106 Iowa L. Rev. 1885, 1888 (2021).

16. An even greater incorporation of stakeholder interests could occur if shareholders were understood to be individuals with diverse preferences, including ethical and social concerns. See Oliver Hart & Luigi Zingales, Companies Should Maximize Shareholder Welfare Not Market Value, 2 J.L. Fin. & Acct. 247, 270 (2017) (arguing that "shareholder welfare and market value are not the same, and that companies should maximize the former not the latter"). Such an approach would require developing improved means to aggregate shareholder preferences.

I. THE CONCURRENT RISE OF CORPORATE GOVERNANCE AND SHAREHOLDER PRIMACY

This Part begins by tracing the coinage of the term "corporate governance" and the context of its conception, and then continues by charting its rise alongside the widespread adoption of shareholder primacy. In so doing, this Part lays the historical foundation for understanding the law, institutions, and culture that make up the modern corporate governance machine. It observes a connection between the term "corporate governance" as it became used in the 1970s and the rise of the shareholder primacy movement that became the dominant paradigm. This relationship is reflected in the common refrain of "good governance" that pervades contemporary discourse and the maturation of corporate governance as an industry, oriented toward serving shareholders and their interests.

A. *The Path to Corporate Governance*

To start, for as long as the corporate form has existed, issues of corporate governance have emerged, although observers at the time did not refer to the issues in those terms. Legal historians commonly pinpoint the 1920s and '30s as the foundational era for early debates.[17] The industrial developments leading up to this time had transformed the economic landscape. The great merger movement starting in the late nineteenth century generated large-scale enterprises and, in turn, created a large number of small shareholders who fueled the growth of the New York Stock Exchange.[18] By the 1920s, millions of Americans had become first-time investors.[19]

17. See, e.g., Harwell Wells, The Birth of Corporate Governance, 33 Seattle U. L. Rev. 1247, 1247–49 (2010) [hereinafter Wells, Birth of Corporate Governance] (examining the concept of "corporate governance" and arguing "for dating the concept's origins to the debates of the 1920s"). For an example of earlier discussion of the problems created by the separation of ownership and control, see Adam Smith, An Inquiry Into the Nature and Causes of the Wealth of Nations 193 (1776) ("The directors of such companies, however, being the managers rather of other people's money than of their own, it cannot well be expected, that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own.").

18. See Wells, Birth of Corporate Governance, supra note 18, at 1253–54; see also Alfred D. Chandler, Jr., The Visible Hand: The Managerial Revolution in American Business 340–44 (1977); Naomi R. Lamoreaux, The Great Merger Movement in American Business, 1895–1904, at 1–2 (1985); Mary O'Sullivan, The Expansion of the U.S. Stock Market, 1885–1930: Historical Facts and Theoretical Fashions, 8 Enter. & Soc'y 489, 489 (2007).

19. See Julia Cathleen Ott, When Wall Street Met Main Street: The Quest for an Investors' Democracy and the Emergence of the Retail Investor in the United States, 1890–1930, 9 Enter. & Soc'y 619, 620 (2008) (estimating that the percentage of U.S. households owning stock rose from approximately 3% to 25% in the early 1900s). The trend accelerated during World War I with great numbers of Americans buying Liberty Bonds to help fund the war. David M. Kennedy, Over Here: The First World War and American Society 105–06 (1980); see also Wells, Birth of Corporate Governance, supra note 18, at 1265.

Amidst this growth in the shareholder class, as well as economic and regulatory upheaval,[20] Adolf Berle and Gardiner Means published their 1932 landmark book, *The Modern Corporation and Private Property*.[21] Building on earlier thinkers, Berle and Means documented the rise of large corporations with dispersed stock and the weakening of shareholder control.[22] But instead of concluding the solution was to reestablish shareholder power as it had existed before the rise of giant industrial companies, they highlighted that the transformation of American capitalism called for a more profound rethinking of "the ends for which the modern corporation can be or will be run."[23] The work was an instant classic—orienting corporate law and theory around the issue of the separation of ownership and control but without elevating the importance of shareholders in the balance.[24]

The vision of corporate managers as socially responsive trustees came to fruition as the economy recovered after World War II.[25] By the mid-twentieth century, "managerial capitalism" reached its zenith, in which "neither boards nor shareholders acted as a robust check on potentially

20. For example, after the stock market crash of 1929 and during the ensuing Great Depression, Congress successively passed the Securities Act of 1933 and the Exchange Act of 1934, creating a framework of federal securities regulation based on a philosophy of disclosure and establishing the Securities and Exchange Commission (SEC) with a "mission of protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation." What We Do, SEC, https://www.sec.gov/about/what-we-do [https://perma.cc/Z8ED-G4QQ] [hereinafter SEC, What We Do] (last visited Aug. 21, 2021); see also Louis Loss, Joel Seligman & Troy A. Paredes, Securities Regulation 301–04, (6th ed. 2019).

21. Adolf A. Berle, Jr. & Gardiner C. Means, The Modern Corporation and Private Property (1932).

22. See Herbert Hovenkamp, Enterprise and American Law: 1836–1937, at 16, 357 (1991) (discussing the argument of Berle and Means "that an inherent attribute of the modern business corporation was the separation of ownership and control"); Wells, Birth of Corporate Governance, supra note 18, at 1289 (discussing the findings of Berle and Means concerning shareholder disempowerment and the separation of ownership and control); see also Walter Werner, Corporation Law in Search of its Future, 81 Colum. L. Rev. 1611, 1612 (1981) (discussing the separation of ownership and control as a longstanding feature of American corporations).

23. Berle & Means, supra note 22, at 7–9.

24. See William W. Bratton & Michael L. Wachter, Shareholder Primacy's Corporatist Origins: Adolf Berle and *The Modern Corporation*, 34 J. Corp. L. 99, 120 (2008) (discussing the work's suggestion that the separation of ownership and control might reflect a "transformation of corporate profits from purely private property to property touched with a public interest"); see also James P. Hawley & Andrew T. Williams, The Rise of Fiduciary Capitalism: How Institutional Investors Can Make Corporate America More Democratic 42 (2000) ("The phenomenon Berle and Means identified in 1932—the divorce of ownership and control—would come to dominate most thinking about issues of corporate governance for the rest of the twentieth century.").

25. See Alfred D. Chandler, Jr., The Competitive Performance of U.S. Industrial Enterprises Since the Second World War, 68 Bus. Hist. Rev. 1, 14 ("By the 1950s, full-time salaried managers, with little equity in the enterprises they operated, were making nearly all operating and strategic decisions.").

wayward executives."[26] Stock ownership was widely dispersed and shareholders lacked the incentive, information, and expertise to exercise voice or provide oversight.[27] Boards dominated by full-time insiders led the nominating process to reelect themselves and fill the remaining seats.[28] Managers were instead checked by what economist John Kenneth Galbraith termed "countervailing power."[29] This force consisted of "industry-level regulation, robust antitrust enforcement, fears of additional heavy-handed government intrusions, powerful unions, and a banking sector reluctant to back risky corporate ventures."[30] Further, corporate managers, "mindful of intense criticism of business in the Depression, took pains to emphasize the good citizenship of the firms they ran."[31] It was during this period that the term "corporate governance" first arose—by a business ethicist advocating for the notion of a "well-tempered corporation" and calling for "a theory of corporate governance consistent with the ideals of a democratic society."[32]

B. *The Birth of Two Concepts*

The 1970s mark the key inflection point that started to turn the tide away from managerial capitalism and set in motion our contemporary system.[33] Early in this trajectory came the spread of the term "corporate governance" beyond its academic origins—it first appeared in the *New York*

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26. Brian R. Cheffins, The Public Company Transformed 37 (2019) [hereinafter Cheffins, Public Company Transformed].

27. Id. at 40.

28. See id. ("Full-time managers held a substantial proportion of board seats, and chief executives would influence choices for the remaining directorships by shaping boardroom discussion about the directorial nominees to be put before the shareholders.").

29. See generally John Kenneth Galbraith, American Capitalism: The Concept of Countervailing Power, at ix (rev. ed. 1993) (asserting "[t]he core thesis that an established and effective answer to economic power is the building of countervailing power").

30. See Cheffins, Public Company Transformed, supra note 27, at 37.

31. Id. at 5; see also Peter F. Drucker, The Responsibilities of Management, Harper's Mag., Nov. 1954, at 67 (observing a "trend among managers to think of themselves almost as public servants, not men driven by a ruthless craving for profits").

32. See Richard Eells, The Government of Corporations, at vii (1962) [hereinafter Eells, Government of Corporations] ("I have tried to emphasize, in this first general treatment of the subject of corporate governance, the importance of constitutionalism as applied to business polities."); Richard Eells, The Meaning of Modern Business: An Introduction to the Philosophy of Large Corporate Enterprise 52, 336 (1960) (discussing the "well-tempered corporation"); see also Bernard Mees, Corporate Governance as a Reform Movement, 21 J. Mgmt. Hist. 194, 195 (2015) (attributing the origins of the term corporate governance to Richard Eells); Mariana Pargendler, The Corporate Governance Obsession, 42 J. Corp. L. 359, 373 n.69 (2016) [hereinafter Pargendler, Corporate Governance Obsession] (same).

33. See Cheffins, Public Company Transformed, supra note 27, at 101–02 (observing "the 1970s provided the platform for change, an inflection point for the postwar industrial system'" (quoting Rakesh Kurana, From Higher Aims to Hired Hands: The Social Transformation of American Business Schools and the Unfulfilled Promise of Management as a Profession 297 (2007))); Lynn A. Stout, On the Rise of Shareholder Primacy, Signs of

Times in 1972[34] and within a few years also appeared in the *Federal Register*.[35] It was no coincidence that this new term came into common usage during the 1970s. One of the great U.S. public companies, Penn Central, collapsed with revelations of commercial bribery, resulting at the time in the "single largest bankruptcy in [the] nation's history."[36] Moreover, around the same time, it came to light that over 350 public corporations had engaged in illicit payments.[37] For years, "the business pages of American newspapers . . . carried a continuing story of corporate misconduct," and the public grew disillusioned with big business.[38] The stock market was producing dismal returns, leading a major business publication to report "The Death of Equities."[39]

Stemming from an analogy between the government and the corporation, corporate governance expressed the notion that limitations on corporate power or misconduct could come through internal constraints.[40] Public-interest activist Ralph Nader, for example, argued that "if corporate governance is to be reformed, it must begin by returning the board to [its] historical role" as "an internal auditor of the corporation, responsible for constraining executive management from violations of law and breach of trust."[41] Likening the board to "a rival branch of government," he argued this reform was necessary because the "autocratic power" of executives "led to recurring violations of law, conflicts of interest, productive inefficiency, and pervasive harm to consumers, workers, and the community environment."[42] For different reasons, both the political left and right

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Its Fall, and the Return of Managerialism (in the Closet), 36 Seattle U. L. Rev. 1169, 1172 (2013) [hereinafter Stout, Rise of Shareholder Primacy] (noting managerial capitalism ran "into headwinds" by the early 1970s).

34. Pargendler, Corporate Governance Obsession, supra note 33, at 373.

35. Id.

36. Cheffins, Public Company Transformed, supra note 27, at 37; SEC, The Financial Collapse of the Penn Central Company: Staff Report of the Securities and Exchange Commission to the Special Subcommittee on Investigations, at iii (1972), https://fraser.stlouisfed.org/files/docs/historical/house/1972house_fincolpenncentral.pdf [https://perma.cc/76J6-27GH].

37. John C. Coffee, Jr., Beyond the Shut-Eyed Sentry: Toward a Theoretical View of Corporate Misconduct and an Effective Legal Response, 63 Va. L. Rev. 1099, 1102–03 (1977) [hereinafter Coffee, Beyond the Shut-Eyed Sentry].

38. Id. at 1101; see also Cheffins, Public Company Transformed, supra note 27, at 105.

39. Cheffins, Public Company Transformed, supra note 27, at 104–05 (citing The Death of Equities: How Inflation Is Destroying the Stock Market, Bus. Wk., Aug. 1979, at 64).

40. See Eells, Government of Corporations, supra note 33, at 184–210 (outlining the analogy between the pursuit of government policy and the pursuit of corporate policy); Pargendler, Corporate Governance Obsession, supra note 33, at 374 ("[T]he emerging view once again was that limitations on corporate power should come from *within* the corporation . . . and . . . cure its apparent failings through internal checks on misconduct.").

41. Ralph Nader, Mark Green & Joel Seligman, Taming the Giant Corporation: How the Largest Corporations Control Our Lives 119 (1976).

42. Id. at 119, 122.

embraced this analogy of controlling managerial power through internal government-like checks and balances.[43]

Notably, this early usage of corporate governance captured the division or balance of power among a particular set of participants—the board of directors, executives, and shareholders. At first, this discourse simply reflected the "received legal model of the corporation" and the era of managerial capitalism that was at its end.[44] For example, in 1976, corporate law scholar Melvin Eisenberg published a widely cited book setting out the legal structure under which "the board of directors manages the corporation's business and makes business policy; the officers act as agents of the board and executive its decisions; and the shareholders elect the board."[45] Without using the term "corporate governance," he critically observed that in practice, managerial power was vested in the executives and that shareholder voting was an empty formality.[46] He advocated for boards to serve a strong monitoring role.[47]

The same year, economist Michael Jensen and business school dean William Meckling injected the economic concept of agency costs into debate about corporations.[48] Jensen and Meckling asserted that "the relationship between the stockholders and manager of a corporation fit the definition of a pure agency relationship."[49] In this vision, the divergence of interests between the shareholders and corporate managers became "agency costs" to be minimized.[50] The corporation itself disappeared as a

43. William W. Bratton, The Separation of Corporate Law and Social Welfare, 74 Wash. & Lee L. Rev. 767, 775–77 (2017) [hereinafter Bratton, The Separation of Corporate Law and Social Welfare] (detailing the rise of the political left's American Corporate Responsibility Movement); Pargendler, Corporate Governance Obsession, supra note 33, at 375 (discussing how conservative business associations have conceded that "the public should be concerned that private business organizations like government itself be subject to checks and balances"); see also Robert Hessen, In Defense of the Corporation, at xiv, xvii (1979) (presenting a neoclassical view that "corporations are created and sustained entirely by an exercise of individual rights, specifically freedom of association and freedom of contract" and "should be held to exactly the same standards of conduct and accountability as everyone else"); Nader et al., supra note 42, at 8–9 (arguing that the "private governments of the megacorporations" should be made more democratic and responsive to "public needs").

44. Melvin Aron Eisenberg, The Structure of the Corporation: A Legal Analysis 2 (1976).

45. Id. at 1.

46. Id. at 97–104, 139–41.

47. Id.; see also infra section III.A.

48. See Michael C. Jensen & William H. Meckling, Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure, 3 J. Fin. Econ. 305, 305 (1976); see also Bratton, The Separation of Corporate Law and Social Welfare, supra note 44, at 777 (observing that the terms "agency costs" and "corporate governance" came into usage "in tandem"); Stout, Rise of Shareholder Primacy, supra note 34, at 1173 (describing how "managerial capitalism fell into academic disrepute" in "the decades following the publication of Jensen and Meckling's article" and was replaced with "shareholder primacy").

49. Jensen & Meckling, supra note 49, at 309.

50. Id.

mere "legal fiction" and "nexus" for contracting.[51] In all, the principal-agent model provided the simple, sticky idea that had been lacking—"a workable model of how a corporation behaves internally."[52]

A normative overlay of what constitutes "good" corporate governance swiftly emerged and came to dominate debates in law and business.[53] Scholars imported economic concepts into corporate law and added a normative lens, mixing the term corporate governance with the principal-agent model. In 1982, for example, Professor Daniel Fischel wrote in *The Corporate Governance Movement*: "As residual claimants on the firm's income stream, shareholders want their agents—the firm's managers—to maximize wealth."[54] Fischel suggested that corporate law, contracting, and markets provided the necessary governance mechanisms to respond to the agency costs "inherent" in the corporate form.[55] Corporations could hire directors as "monitors" and "managerial contracts can provide managers with incentives to maximize shareholders' welfare," such as by tying manager's compensation to the company's share price.[56] According to this theory, focusing management attention on shareholder wealth would best maximize corporate value and also social welfare, as other bodies of law could regulate corporate externalities that would harm the public.[57]

In sum, while at the start of the 1970s the term corporate governance had initially connoted "a political structure to be governed,"[58] embraced by those "taming the giant corporation" in the public interest,[59] by the early 1980s, louder voices had started to prevail in focusing the term's meaning on reducing agency costs to serve shareholder interests. Corporate governance underwent a "revolution" toward the "monitoring model."[60] Further, scholars began to embrace characterizations of corporate social responsibility as an ill-conceived basis for business regulation or management.[61] Milton Friedman's view—that the corporation has "only

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51. See id. at 310.

52. See Coffee, Beyond the Shut-Eyed Sentry, supra note 38, at 1109–10 (noting in a 1977 article the lack of such a workable model and how "corporate practitioners and legal academicians tend to view the corporation as a 'black box'").

53. See Cheffins, Public Company Transformed, supra note 27, at 5 ("Under the mantle of better 'corporate governance,' a term rarely used before the mid-1970s, 'internal' constraints had been strengthened since the heyday of managerial capitalism.").

54. Daniel R. Fischel, The Corporate Governance Movement, 35 Vand. L. Rev. 1259, 1262 (1982).

55. Id.

56. Id. at 1263.

57. See Frank H. Easterbrook & Daniel R. Fischel, The Corporate Contract, 89 Colum. L. Rev. 1416, 1436 (1989).

58. Brian R. Cheffins, The Corporate Governance Movement, Banks, and the Financial Crisis, 16 Theoretical Inquiries L. 1, 6 (2015).

59. See Nader et al., supra note 42.

60. George W. Dent, Jr., The Revolution in Corporate Governance, the Monitoring Board, and the Director's Duty of Care, 61 B.U. L. Rev. 623, 623 (1981).

61. Fischel, supra note 55, at 1268–73.

one social responsibility . . . to increase its profit so long as it stays within the rules of the game”[62]—gained adherents.

C. *The Reign of Shareholder Primacy and Good Governance*

The birth of corporate governance and its linkage with shareholder primacy became the dominant mode of discourse in the decades that followed. During the Deal Decade of the 1980s, terminology and concepts that might have remained in a dusty corner of the ivory tower were instead thrust into the limelight as a record number of unsolicited tender offers became proof of a “market for corporate control” and sharpened managers’ focus on producing “shareholder value” lest they become a target.[63] Rapid growth in share ownership by institutional investors reinforced this dynamic of pressure on public company boards and executives as large shareholders expressed their enthusiasm for takeover bids.[64] In contrast to the considerable autonomy that boards and executives had enjoyed in previous times, during this period of frenzied M&A activity, management “found themselves under a novel, heavy onus to respond to shareholder preferences.”[65] Blockbuster cases in Delaware courts on directors’ fiduciary duties in the sale context such as *Smith v. Van Gorkom*[66] and *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*[67] reflected the shift in thinking toward agency theory and a monitoring board that served shareholders.

A clear sign of a shifting tide away from managerial capitalism and toward shareholder primacy can be found in the ensuing debate about whether boards should consider the interests of groups other than shareholders when determining whether to defend against a hostile takeover. During this time, employees, customers, suppliers, and local communities became “stakeholders” and “constituencies.”[68] Whereas earlier references

62. See Milton Friedman, A Friedman Doctrine—The Social Responsibility of Business Is to Increase Its Profits, N.Y. Times Mag., Sept. 13, 1970, https://www.nytimes.com/1970/09/13/archives/a-friedman-doctrine-the-social-responsibility-of-business-is-to.html (on file with the *Columbia Law Review*) (quoting Milton Friedman, Capitalism and Freedom 133 (1962)).

63. See Cheffins, Public Company Transformed, supra note 27, at 151, 155–56, 162–64, 181.

64. Id. at 196.

65. Id. at 156, 212; see also Brian R. Cheffins, Stop Blaming Milton Friedman!, 98 Wash. U. L. Rev. 1607, 1611–13, 1628–33 (2021) (explaining that the intellectual underpinnings from the 1970s for shareholder primacy took hold during the hostile takeover wave of the 1980s).

66. 488 A.2d 858, 874–78 (Del. 1985) (holding that the directors breached the fiduciary duty of care in approving a cash-out merger because, among other things, the board did not make an informed business judgment about the value of the company).

67. 506 A.2d 173, 182 (Del. 1986) (holding that when “the break-up of the company was inevitable,” the “duty of the board had thus changed from the preservation of [the company] as a corporate entity to the maximization of the company’s value at a sale for the stockholders’ benefit”).

68. See id. at 176 (“[W]e address for the first time the extent to which a corporation may consider the impact of a takeover threat on constituencies other than shareholders.”);

had highlighted the essential support that stakeholders provided to corporations,[69] in the 1980s this terminology began to treat as "other" the corporate participants who did not hold equity.[70] At the same time, shareholders were consistently given precedence: Only two public corporations used the term "shareholder value" in annual reports before 1983, but by 1985, over fifty did so and a majority of CEOs surveyed said that creating shareholder value was their top priority.[71]

Thus, by the end of the 1980s, the separation of ownership and control became "the master problem,"[72] and pursuing shareholder value was regularly identified as a core corporate objective.[73] In addition, the term "corporate governance" exploded in use, most typically in regard to corporate boards, executive performance, and shareholder involvement.[74] A congressional report aptly summarized: "While the corporate reformers of the 1970s urged that 'accountability' meant being a good corporate citizen answerable to society as a whole, observers might now suggest that 'accountability' in the 1980s means keeping stock prices high for stockholders . . . ."[75]

Furthermore, during this time, shareholder primacy came to represent more than a directive for boards and managers to serve shareholders by maximizing share price. Some proponents additionally argued that

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John C. Coffee, Jr., The Uncertain Case for Takeover Reform: An Essay on Stockholders, Stakeholders and Bust-Ups, 1988 Wis. L. Rev. 435, 440 (discussing the "conflict over takeovers" that "divides shareholders and stakeholders"); Roberta Romano, Metapolitics and Corporate Law Reform, 36 Stan. L. Rev. 923, 979 (1984) (examining arguments for corporate law reform including the interests of "'other constituencies,' which include employees and local communities" (quoting Martin Lipton, Takeover Bids in the Target's Boardroom, 35 Bus. Law. 101, 104 (1979))) [hereinafter Romano, Metapolitics].

69. R. Edward Freeman & David L. Reed, Stockholders and Stakeholders: A New Perspective on Corporate Governance, 25 Cal. Mgmt. Rev. 88, 89 (1983) (noting that the term "stakeholders" originated in a 1963 Stanford Research Institute memorandum to describe "those groups without whose support the organization would cease to exist").

70. See, e.g., Lynn A. Stout, New Thinking on "Shareholder Primacy", Acct. Econ. & L., June 2012, at 1, 3 [hereinafter Stout, New Thinking] ("Some commentators continued to argue valiantly for a more stakeholder-friendly view of the public corporation, but they were increasingly dismissed as sentimental, sandals-wearing leftists whose hearts outweighed their heads.").

71. Cheffins, Public Company Transformed, supra note 27, at 187.

72. Id. at 182; Romano, Metapolitics, supra note 69, at 923. For a discussion of the costs of collective decisionmaking and its bearing on firm structure and ownership patterns, including the dominance of investor-owned enterprise, see Henry Hansmann, The Ownership of Enterprise 53–65 (1996) [hereinafter Hansmann, Ownership of Enterprise].

73. Cheffins, Public Company Transformed, supra note 27, at 186.

74. Brian R. Cheffins, Delaware and the Transformation of Corporate Governance, 40 Del. J. Corp. L. 1, 8 (2015) ("By the end of the 1990s, 'corporate governance' had become the term of art most typically used to characterize the analysis of boards, executive pay, and shareholder involvement in publicly traded companies.").

75. H.R. Subcomm. on Telecomms., Consumer Prot. & Fin. of the Comm. on Energy & Com., 99th Cong., Corporate Takeovers: Public Policy Implications for the Economy and Corporate Governance 77 (Comm. Print 1987).

shareholders should have greater power in the corporation.[76] Shareholder primacy therefore came to encompass both the "ends" of corporate decisionmaking—i.e., that the purpose of corporation is to maximize shareholder wealth—as well as the means.[77] Although the former conception gained greater adherence, in various degrees these two visions of shareholder primacy fueled the next several decades of governance reform. Boards overhauled their CEO compensation practices to "pay for performance," giving executives equity-based compensation to align their interests with shareholders.[78] Executives focused their attention on investor expectations and quarterly earnings.[79] Despite the lack of conclusive empirical support, "best practices" for "good governance" spread, such as separating the roles of CEO and chairperson, eliminating staggered boards, and adopting majority voting.[80] In the twenty-first century, as hostile takeovers and the market for corporate control waned, activist shareholders emerged to push for these changes under the governance mantle and often with the aim of pursuing their own profits.[81] The rise of investing through intermediaries amplified the potential for shareholder influence as stock ownership became increasingly concentrated in a small number of mutual funds and other institutions.[82]

76. See Harwell Wells, A Long View of Shareholder Power: From the Antebellum Corporation to the Twenty-First Century, 67 Fla. L. Rev. 1033, 1089 (2015) [hereinafter Wells, A Long View]; see also Lucian Arye Bebchuk, The Case for Increasing Shareholder Power, 118 Harv. L. Rev. 833, 840 n.6 (2005).

77. Bainbridge, Director Primacy, supra note 3, at 563; Thompson, Anti-Primacy, supra note 3.

78. See Michael B. Dorff, Indispensable and Other Myths: Why the CEO Pay Experiment Failed and How to Fix It 6 (2014) (explaining that the "heavy use of performance pay" for CEOs began in the 1980s); see also Lucian Bebchuk & Jesse Fried, Pay Without Performance: The Unfulfilled Promise of Executive Compensation 1–2 (2004) (discussing the "official view" that boards design CEO compensation to "provide executives with incentives to increase shareholder value" and noting that "the value of stock options granted to CEOs" in the 1990s "jump[ed] ninefold"); Brian J. Hall, Six Challenges in Designing Equity-Based Pay, 15 J. Applied Corp. Fin. 21, 23 (2003) (finding that median equity-based compensation of executives at S&P 500 companies rose from 0% in 1984 to 66% in 2001).

79. See Cheffins, Public Company Transformed, supra note 27, at 369–705.

80. See David F. Larcker & Brian Tayan, Stanford Closer Look Series, Loosey-Goosey Governance: Four Misunderstood Terms in Corporate Governance 1–2 (2019), https://www.gsb.stanford.edu/sites/default/files/publication-pdf/cgri-closer-look-79-loosey-goosey-governance.pdf [https://perma.cc/X7D4-SSWV].

81. See, e.g., William W. Bratton, Hedge Funds and Governance Targets, 95 Geo. L.J. 1375, 1381 (2007) (describing hedge fund activism); Marcel Kahan & Edward Rock, Embattled CEOs, 88 Tex. L. Rev. 987, 995–1005 (2010) (discussing changes in shareholder composition and activism).

82. See Bernard S. Black, Agents Watching Agents: The Promise of Institutional Investor Voice, 39 UCLA L. Rev. 811, 813–14 (1992); John C. Coffee, Jr., Liquidity Versus Control: The Institutional Investor as Corporate Monitor, 91 Colum. L. Rev. 1277, 1291–93 (1991); Ronald J. Gilson & Jeffrey N. Gordon, The Agency Costs of Agency Capitalism: Activist Investors and the Reevaluation of Governance Rights, 113 Colum. L. Rev. 863, 865–

In sum, the result of this evolution is that shareholder wealth maximization became ingrained in the very notion of "mainstream" corporate governance. Critical perspectives received labels such as "progressive corporate law" and "stakeholderism."[83] By 2001, in a provocatively titled article, *The End of History for Corporate Law*, Professors Henry Hansmann and Reinier Kraakman proclaimed that "[t]here is no longer any serious competitor to the view that corporate law should principally strive to increase long-term shareholder value."[84]

II. THE CORPORATE GOVERNANCE MACHINE

As the previous discussion illuminates, the term corporate governance was initially intended as a tool to constrain corporate power for the benefit of the public, but it subsequently developed to embody a particular view of the internal workings of the corporation, with shareholders paramount and directors and managers serving as their agents.

In this Part, we describe how this intellectual legacy underpins the contemporary U.S. corporate governance system. More specifically, we describe the corporate governance machine and its three reinforcing components: law, institutions, and culture.[85] We show that each element orients corporations in one direction—toward advancing shareholder interests. For each component, we discuss the key players and institutions that are traditionally considered participants in corporate law and governance.[86] Although an even broader approach could be taken and discussion

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69 (2013); Edward B. Rock, Adapting to the New Shareholder-Centric Reality, 161 U. Pa. L. Rev. 1907, 1922 (2013) [hereinafter Rock, Shareholder-Centric Reality].

83. For a sampling of this literature and discussion of critical perspectives on corporate law, see Progressive Corporate Law (Lawrence E. Mitchell ed., 1995); Kent Greenfield, The Failure of Corporate Law: Fundamental Flaws and Progressive Possibilities 126–27 (2010); Matthew T. Bodie, The Next Iteration of Progressive Corporate Law, 74 Wash. & Lee L. Rev. 739, 739–40 (2017); Martin Gelter, Taming or Protecting the Modern Corporation? Shareholder-Stakeholder Debates in a Comparative Light, 7 N.Y.U. J.L. & Bus. 641, 666 (2011) [hereinafter Gelter, Taming or Protecting the Modern Corporation]; David Millon, New Directions in Corporate Law: Communitarians, Contractarians, and the Crisis in Corporate Law, 50 Wash. & Lee L. Rev. 1373, 1377 (1993).

84. Hansmann & Kraakman, supra note 3, at 439–41.

85. For discussion of the definition and significance of a "system," see Draper L. Kauffman, Jr., Systems One: An Introduction to Systems Thinking 1, 3 (1980) ("[A] system is a collection of parts which interact with each other to function as a whole."); Tamara Belinfanti & Lynn Stout, Contested Visions: The Value of Systems Theory for Corporate Law, 166 U. Pa. L. Rev. 579, 599 (2018) ("A system has been defined as any set of distinct but interconnected elements or parts that operate as a unified whole to serve a function or purpose."); Lynn M. LoPucki, The Systems Approach to Law, 82 Cornell L. Rev. 479, 482–83 (1997) ("To 'analyze' a system is to break it down into its constituent parts, to determine the nature and identity of its subsystems, and to explain the relationships among them.").

86. See Ann M. Lipton, Beyond Internal and External: A Taxonomy of Mechanisms for Regulating Corporate Conduct, 2020 Wis. L. Rev. 657, 659 [hereinafter Lipton, Beyond Internal and External] (discussing how "corporate and securities law are viewed as 'internal' to the corporation and as such, dictate the architecture of the corporate form and its decisionmaking processes," whereas "other areas . . . such as antitrust, labor and employment

of each component could fill a volume, we take a bird's-eye view to better understand the system in which U.S. public corporations operate.

A. *Law*

In many accounts, law is the central focus for understanding corporate governance. We begin our exploration of the corporate governance machine with this component, setting out the main actors that create corporate law and regulate the business affairs of corporations: Delaware, Congress, and two federal agencies: the SEC and the DOL. Together, these actors reflect all branches of government, interacting and constraining each other through principles of federalism. In particular, these actors interact in a dynamic way: State corporate law generally specifies internal corporate affairs, while federal law provides a securities law overlay and occasionally intervenes after periods of crisis. Importantly, federal law also facilitated the aggregation of governance power in the hands of institutional shareholders over the past several decades and influences how that power is exercised. And as the following sections describe in detail, this multifaceted legal regime has maintained a shareholder-oriented equilibrium for the past several decades.

1. *Delaware.* — For more than a century, Delaware has held the top honor of being home to the greatest number of public corporations and producing the most influential corporate law.[87] In turn, the question of corporate purpose—the issue at the core of corporate governance, which shapes fiduciary decisionmaking and affects the legal landscape in myriad ways—is typically framed as whether Delaware legally requires fiduciaries to maximize shareholder wealth.

Since the Deal Decade of the 1980s, statements in Delaware case law and by prominent judges have suggested that directors must "make stockholder welfare their sole end, and that other interests may be taken into consideration only as a means of promoting stockholder welfare."[88] But a

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law, intellectual property law, . . . and the like, are conceptualized as 'external' regulation"); Elizabeth Pollman, The Supreme Court and the Pro-Business Paradox, 135 Harv. L. Rev. 220, 247–61 (2021) (describing the relationship between the internal and external governance of corporations and the impact of Supreme Court jurisprudence on corporations).

87. Mark J. Roe, Delaware's Politics, 118 Harv. L. Rev. 2491, 2493–94 (2005).

88. Leo E. Strine, Jr., The Dangers of Denial: The Need for a Clear-Eyed Understanding of the Power and Accountability Structure Established by the Delaware General Corporation Law, 50 Wake Forest L. Rev. 761, 768 (2015); see also Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986) ("[W]hile concern for various corporate constituencies is proper when addressing a takeover threat, that principle is limited by the requirement that there be some rationally related benefit accruing to the stockholders."); In re Trados Inc. S'holder Litig., 73 A.3d 17, 36 (Del. Ch. 2013) ("[T]he standard of conduct requires that directors seek 'to promote the value of the corporation for the benefit of its stockholders.'" (quoting eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 34 (Del. Ch. 2010))); *eBay*, 16 A.3d at 33 ("Promoting, protecting, or pursuing nonstockholder considerations must lead at some point to value for stockholders.").

vocal group of legal scholars have persistently pushed back on this interpretation in favor of a broader view of corporate purpose and fiduciary discretion. Some, for example, have argued that the deferential standard of judicial review known as the business judgment rule means that, practically speaking, directors are not legally constrained in their decisionmaking to maximize shareholder value in most circumstances.[89] In recent years, however, the Delaware Court of Chancery has dealt several blows to these interpretations. For example, in *eBay Domestic Holdings, Inc. v. Newmark*, the court rejected the argument that the founders of Craigslist could prioritize their community over their shareholders, stating the court "cannot accept as valid . . . a corporate policy that specifically, clearly, and admittedly seeks *not* to maximize the economic value of a for-profit Delaware corporation for the benefit of its stockholders."[90] And, although the Delaware Supreme Court has not revisited this issue since its takeover jurisprudence of the 1980s,[91] a handful of other Chancery Court opinions contain similar statements.[92]

In addition to this—albeit relatively scant—language from Delaware courts emphasizing the interests of shareholders as the ultimate corporate ends, the Delaware General Corporation Law gives shareholders important control rights.[93] For example, shareholders are the only corporate constituency with the statutory power to elect board members and to

89. See, e.g., Lynn Stout, The Shareholder Value Myth: How Putting Shareholders First Harms Investors, Corporations, and the Public 30–31 (2012) [hereinafter Stout, Shareholder Value Myth]; Margaret M. Blair & Lynn A. Stout, A Team Production Theory of Corporate Law, 85 Va. L. Rev. 247, 308–09 (1999); Einer Elhauge, Sacrificing Corporate Profits in the Public Interest, 80 N.Y.U. L. Rev. 733, 763–69 (2005).

90. 16 A.3d at 34.

91. See Cynthia Williams, The Future of Shareholder Wealth Maximization: A Response to George Mocsary, Law & Liberty (Dec. 23, 2013), https://www.lawliberty.org/liberty-forum/the-future-of-shareholder-wealth-maximization-a-response-to-george-mocsary/ [https://perma.cc/7XTF-BHW2] (arguing that the Delaware Supreme Court has not explicitly required shareholder wealth maximization); see also Robert J. Rhee, A Legal Theory of Shareholder Primacy, 102 Minn. L. Rev. 1951, 1957 (2018) (noting that the case law on a duty to maximize shareholder value is "scant").

92. See, e.g., N. Am. Cath. Educ. Programming Found., Inc. v. Gheewalla, 930 A.2d 92, 101 (Del. 2007) (stating that in a solvent corporation, "[t]he directors of Delaware corporations have 'the legal responsibility to manage the business of a corporation for the benefit of its shareholder[] owners'" (quoting Malone v. Brincat, 722 A.2d 5 (Del. 1988))); Quadrant Structured Prods. Co. v. Vertin, 102 A.3d 155, 172 (Del. Ch. 2014) (stating that the standard of conduct for directors is "maximiz[ing] the value of the corporation for the benefit of its residual claimants" and "[i]n a solvent corporation, the residual claimants are the stockholders"); *Trados*, 73 A.3d at 37 ("[T]he duty of loyalty therefore mandates that directors maximize the value of the corporation over the long-term for the benefit of the providers of equity capital . . . ."); Air Prods. & Chems., Inc. v. Airgas, Inc., 16 A.3d 48, 129 (Del. Ch. 2011) ("Directors of a corporation still owe fiduciary duties to all stockholders . . . .").

93. Leo E. Strine, Jr., Corporate Power Is Corporate Purpose I: Evidence From My Hometown, 33 Oxford Rev. Econ. Pol'y 176, 179 (2017) (asserting that "stockholders are the only corporate constituency with power under our prevailing system of corporate governance") [hereinafter Strine, Corporate Power]; cf. Thompson, Anti-Primacy, supra note

bring derivative suits to hold them accountable.[94] Delaware has also amended its corporate code to provide the option of organizing as a "public benefit corporation," further suggesting that pursuing stakeholder interests is not the default rule for corporations.[95] For these reasons, many have observed that Delaware's default simply allows for an "enlightened" approach to shareholder primacy by leaving fiduciaries discretion to determine the value-maximizing course of action for shareholders over the long term.[96] On the whole, from a relatively small number of cases and statutory provisions, the idea that shareholder primacy is the law of the land in Delaware has become "widely accepted" in business, legal, and academic communities.[97]

Stepping back, however, we can appreciate that the power structure under Delaware corporate law that awards rights to shareholders and imposes on directors a fiduciary duty to act in the shareholders' interests is an important component of the corporate governance machine, but it is not dispositive. Indeed, that power structure has been in place for decades and was present during the era of managerialism that preceded it.[98] This reality suggests that other features of the corporate governance machine are responsible for its shareholderist orientation and that changes in Delaware corporate law might not be the key that many view them to be. The next sections discuss how federal law further reinforces a shareholder primacy view and, in many ways, a more exacting standard than that of Delaware.

3, at 403–10 (discussing how corporate law creates shared power between managers, directors, and shareholders). For discussions of the efficiency of the corporate structure giving shareholders voting power and addressing the needs of other constituencies by contract, see Hansmann, Ownership of Enterprise, supra note 73; Oliver E. Williamson & Janet Bercovitz, The Modern Corporation as an Efficiency Instrument: The Comparative Contracting Perspective, *in* The American Corporation Today 327, 333–40 (Carl Kaysen ed., 1996).

94. Strine, Corporate Power, supra note 94, at 178–79 (referencing Del. Code tit. 8, §§ 251, 271, 327 (2016)). Creditors join shareholders in the power to bring derivative suits to enforce fiduciary duties only when the corporation is insolvent. Quadrant Structured Prods. Co. v. Vertin, 115 A.3d 535, 546 (Del. Ch. 2015).

95. See Del. Code tit. 8, § 362 (2021).

96. See, e.g., Harper Ho, Enlightened Shareholder Value, supra note 13, at 74–75 (explaining that shareholder wealth maximization is generally regarded as a "norm of corporate behavior" and Delaware law provides "broad discretion" to directors that allows for decisions that benefit nonshareholders).

97. Rhee, supra note 92, at 1951, 1953–54 ("The data show that courts have pervasively embraced the concept that corporate managers should maximize shareholder wealth."); see also Joan Macleod Heminway, Shareholder Wealth Maximization as a Function of Statutes, Decisional Law, and Organic Documents, 74 Wash. & Lee L. Rev. 939, 944 (2017) (describing "shareholder wealth maximization under various state laws (in and outside Delaware) as a function of firm-level corporate governance").

98. See Wells, A Long View, supra note 77, at 1076 (observing that shareholders had "the basic legal rights . . . to vote, sell, and sue" during the mid-twentieth century period of managerialism).

2. *Congress.* — From time to time, the federal government has taken on issues of corporate governance with national importance.[99] What shape do these incursions take? In the twenty-first century, since shareholder primacy has permeated the cultural and political discourse, federal intervention tends to protect shareholders, increasing their power and focusing management attention on their interests.[100] Consider, for example, corporate governance reforms enacted under the Dodd–Frank Act in the wake of the financial crisis: requiring a "say-on-pay" shareholder vote on executive compensation at public companies, providing for executive compensation clawbacks under certain circumstances, and allowing proxy access for shareholders to challenge incumbent management.[101] Likewise, the Sarbanes–Oxley Act of 2002 imposed shareholder-friendly corporate governance requirements, including stronger independence requirements for certain board committees.[102] That Act also required top executives to certify financial statements, with steep penalties for false certifications.[103] Each of these reforms incrementally tilted the balance of power in favor of shareholders.[104]

There are a handful of recent counterexamples, which demonstrate that the trend toward shareholder protection is not absolute and yet ultimately reinforce our general point. Perhaps the most well-known is the

99. See Stephen M. Bainbridge, The Creeping Federalization of Corporate Law, Regulation, Spring 2003, at 26 ("[T]here has been a creeping—but steady—federalization of corporate governance law."); Mark J. Roe, Delaware's Competition, 117 Harv. L. Rev. 588, 590 (2003) [hereinafter Roe, Delaware's Competition] ("Delaware's chief competitive pressure comes not from other states but from the federal government.").

100. See Christopher M. Bruner, Center-Left Politics and Corporate Governance: What Is the "Progressive" Agenda?, BYU L. Rev. 267, 286 (2018) (observing that "[s]ince the turn of the millennium, shareholder-centric corporate governance reforms at the federal level have picked up pace"); see also Lucian A. Bebchuk & Assaf Hamdani, Federal Corporate Law: Lessons From History, 106 Colum. L. Rev. 1793, 1799–816 (2006) (finding that federal intervention in corporate law has imposed tighter constraints on insiders to increase investor protection); cf. Lipton, Beyond Internal and External, supra note 87, at 659 (observing that when Congress legislates for stakeholders, it is typically viewed as "external" to corporate governance).

101. See Stephen M. Bainbridge, Dodd-Frank: Quack Federal Corporate Governance Round II, 95 Minn. L. Rev. 1779, 1783 (2011) (outlining key corporate governance provisions of the Dodd–Frank Act).

102. Robert Charles Clark, Corporate Governance Changes in the Wake of the Sarbanes-Oxley Act: A Morality Tale for Policymakers Too, 22 Ga. St. U. L. Rev. 251, 255–56 (2005).

103. Id. at 264.

104. That was so despite the fact that many viewed shareholder primacy as contributing to the crises that brought about the regulation. See, e.g., William W. Bratton, Enron and the Dark Side of Shareholder Value, 76 Tul. L. Rev. 1275, 1283–84 (2002) (suggesting that the "pursu[it] of maximum shareholder value" contributed to the Enron scandal); see also Larry E. Ribstein, Bubble Laws, 40 Hous. L. Rev. 77, 82 (2003) ("Public attention may be focused more on punishing the guilty than on preventing future harms.").

Dodd–Frank provision directing the SEC to issue a rule requiring companies to disclose their use of "conflict minerals."[105] The rule was not adopted to further shareholder interests; it was enacted out of humanitarian concern about social harms arising from warfare in central Africa.[106] And it was immediately challenged in federal court by industry associations—the National Association of Manufacturers, the Chamber of Commerce, and the Business Roundtable.[107] After years of litigation, the D.C. Circuit concluded that the rule's disclosure requirements violated the First Amendment.[108] Then, in 2017, acting SEC Commissioner Michael Piwowar called the rule "misguided" and implied that the SEC would not enforce the rule's remaining requirements, which concerned due diligence on the source and chain of custody of conflict minerals.[109] That same year, signs emerged that even members of Congress viewed the conflict minerals rule as a mistake—the House of Representatives twice passed bills that would eradicate the rule by repealing or eliminating funding for it.[110] This uncertainty has led many corporations to ignore the rule's requirements, as if never enacted into law.[111] Ultimately, this pushback against Dodd–Frank's conflict minerals rule reinforces our observation that Congress usually intervenes in corporate governance to serve

105. Press Release, SEC, SEC Adopts Rule for Disclosing Use of Conflict Minerals (Aug. 22, 2012), https://www.sec.gov/news/press-release/2012-2012-163htm [https://perma.cc/A9V2-TRLA].

106. See Fact Sheet: Disclosing the Use of Conflict Minerals, SEC, https://www.sec.gov/opa/Article/2012-2012-163htm—related-materials.html [https://perma.cc/5NEF-7HF2] (last updated Mar. 14, 2017) (citing concern "that the exploitation and trade of conflict minerals by armed groups . . . help[s] to finance conflict in the DRC region").

107. Carter Wood, Conflict Minerals Rule: Extraordinary Costs, Doubtful Benefits, Bus. Roundtable (Jan. 18, 2013), https://www.businessroundtable.org/archive/media/blog/conflict-minerals-rule-extraordinary-costs-doubtful-benefits [https://perma.cc/ZFZ4-AS5P].

108. Nat'l Ass'n of Mfrs. v. Sec. & Exch. Comm'n, 800 F.3d 518, 530 (D.C. Cir. 2015) ("By compelling an issuer to confess blood on its hands, the statute interferes with the exercise of that freedom of speech under the First Amendment.").

109. See Michael S. Piwowar, Reconsideration of Conflict Minerals Rule Implementation, SEC (Jan. 31, 2017), https://www.sec.gov/news/statement/reconsideration-of-conflict-minerals-rule-implementation.html [https://perma.cc/5SFV-PS86]; Michael S. Piwowar, Statement of Acting Chairman Piwowar on the Court of Appeals Decision on the Conflict Minerals Rule, SEC (Apr. 7, 2017), https://www.sec.gov/news/public-statement/piwowar-statement-court-decision-conflict-minerals-rule [https://perma.cc/W5WK-TC88]; SEC Div. of Corp. Fin., Updated Statement on the Effect of the Court of Appeals Decision on the Conflict Minerals Rule, SEC (Apr. 7, 2017), https://www.sec.gov/news/public-statement/corpfin-updated-statement-court-decision-conflict-minerals-rule/ [https://perma.cc/LUL7-MW7A].

110. Packaging Law at Keller & Heckman LLP, Conflict Minerals Rule Faces Uncertain Future, Nat'l L. Rev. (Oct. 6, 2017), https://www.natlawreview.com/article/conflict-minerals-rule-faces-uncertain-future [https://perma.cc/HSL7-6TBH] (referencing H.R. 3354, 115th Cong. (2017) and H.R. 10, 115th Cong. (2017)).

111. Kelly Franklin, US Investors Chide Companies for Thin Conflict Minerals Reports, Chem. Watch (June 14, 2018), https://chemicalwatch.com/67693/us-investors-chide-companies-for-thin-conflict-minerals-reports (on file with the *Columbia Law Review*).

shareholder interests and, to the extent it is perceived as veering from that path, the corporate governance machine stands ready to push back.

3. *Securities and Exchange Commission.* — Congress often delegates rulemaking and enforcement to agencies, and in this section, we focus on the most influential regulator of corporate behavior: the SEC, which was created after the stock market crash of 1929 and the Great Depression that ensued.[112] The agency articulates its mission as threefold: to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation.[113] The fact that the most influential regulator of financial markets and corporate behavior is charged with protecting *investors* suggests that advancing shareholder interests is a strong, if not dominant, focus for federal securities law.[114] Two aspects of the law illustrate this point: periodic corporate reporting requirements and SEC regulation of corporate affairs.

First, publicly traded companies are subject to periodic reporting requirements aimed at informing investors of information that is material to their trading.[115] Indeed, all corporate disclosure is subject to securities law, which frames its focus on generating information that is necessary or beneficial for investors, rather than for stakeholders or the general public.[116] Federal securities laws embed this directive in the definition of "materiality," which courts have defined as whether there is a "substantial likelihood" that a "reasonable investor" would view the information as significant.[117] If information about a company's harmful practices is not material to investors, for example, the company might not disclose such

112. Loss et al., supra note 20, at 301–04; see also Securities Exchange Act of 1934, Pub. L. No. 73-291, 48 Stat. 881 (codified as amended in 15 U.S.C. § 78a et seq. (2018)).

113. SEC, What We Do, supra note 21.

114. Recent scholarship has argued that "securities laws force public companies to conform to the shareholder primacy view of corporate purpose" because the "fear of activist intervention" incentivizes companies "to maximize stock prices at the expense of all else." Jeff Schwartz, De Facto Shareholder Primacy, 79 Md. L. Rev. 652, 655–56 (2020).

115. See SEC, What We Do, supra note 21. The accounting standards that the SEC has adopted further enshrine a shareholder primacy view. See William W. Bratton, Private Standards, Public Governance: A New Look at the Financial Accounting Standards Board, 48 B.C. L. Rev. 5, 37 (2007) (discussing how the Financial Accounting Standards Board aligned itself with "the broader economic shift away from managerialism and toward capital market governance under the norm of shareholder value").

116. See Donald C. Langevoort & Robert B. Thompson, "Publicness" in Contemporary Securities Regulation After the JOBS Act, 101 Geo. L.J. 337, 375–79 (2013) (noting that "the conventional story for mandatory disclosure" focuses on "individual firms and . . . investors," although disclosure is also justified on the basis of "benefits to all citizens"); Ann M. Lipton, Not Everything Is About Investors: The Case for Mandatory Stakeholder Disclosure, 37 Yale J. on Regul. 499, 502 (2020) [hereinafter Lipton, Mandatory Stakeholder Disclosure] ("[S]ecurities disclosures are not targeted toward the community at large; they are intended for investors alone, and when investors do not require disclosure, the general public is kept in the dark.").

117. Basic Inc. v. Levinson, 485 U.S. 224, 231–32 (1988) (quoting TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976)).

information, no matter the value of the information to the public.[118] In addition to regulating disclosure, the agency wields enforcement power against those who make fraudulent statements and omissions in connection with the purchase or sale of securities.[119] Quite obviously, these rules are intended to protect investors from fraud, and the ex ante effect is that issuers are highly focused on revealing information material *to investors* in a truthful manner.

Second, certain internal corporate affairs are subject to extensive regulation from the SEC, and the agency has repeatedly used its authority to protect shareholders as a group. Consider shareholder proposals. For years, the SEC has served as a gatekeeper by determining whether particular shareholder proposals must be included in public companies' annual proxy statements.[120] The SEC is the arbiter of exclusionary grounds, such as whether a proposal is "substantially related" to the company's business or an "ordinary business" matter, and it has significant power to filter which proposals involving social and governance issues make it onto a corporation's proxy.[121] And the SEC regulates not just the content of shareholder proposals, but also how investors vote on them. For example, the

118. Commission Guidance Regarding Disclosure Related to Climate Change, Exchange Act Release Nos. 33-9106, 34-61469, FR-82, 75 Fed. Reg. 6290, 6294–96 (Feb. 8, 2010); see also Jill E. Fisch, Making Sustainability Disclosure Sustainable, 107 Geo. L.J. 923, 935 (2019) (noting that the "benchmark is whether the information is material to investors" and "[t]he SEC's usual position is that . . . [materiality] should be understood in terms of the information's economic or financial impact" and, with limited exception, "has not required issuers to disclose specific categories of sustainability information"); Virginia Harper Ho, Disclosure Overload? Lessons for Risk Disclosure & ESG Reporting Reform From the Regulation S-K Concept Release, 65 Vill. L. Rev. 67, 74 (2020) (finding that investors are concerned about "*under-disclosure* of material information" under the existing interpretation of SEC disclosure rules).

119. SEC, What We Do, supra note 21.

120. Shareholder Proposals, 17 C.F.R. § 240.14a-8 (2020); see also Donna M. Nagy, Judicial Reliance on Regulatory Interpretations in SEC No-Action Letters: Current Problems and a Proposed Framework, 83 Cornell L. Rev. 921, 923–25, 938–40 (1998) (describing the SEC's practice of issuing no-action letters); Alan R. Palmiter, The Shareholder Proposal Rule: A Failed Experiment in Merit Regulation, 45 Ala. L. Rev. 879, 879–85 (1994) (explaining the SEC's promulgation of the 14a-8 shareholder proposal rule and its gatekeeping role).

121. See, e.g., J. Robert Brown, Jr., The Politicization of Corporate Governance: Bureaucratic Discretion, the SEC, and Shareholder Ratification of Auditors, 2 Harv. Bus. L. Rev. 501, 502–03 (2012) (describing how "the SEC has increasingly been called upon to develop substantive standards and to arbitrate the often irreconcilable positions of interests groups vying to influence the governance process" and how "the SEC has as its regulatory mission the protection of shareholders and investors"); Lipton, Mandatory Stakeholder Disclosure, supra note 117, at 554 (describing how proposals explicitly framed as requests for management to pursue objectives other than shareholder wealth maximization would be "on shaky legal ground"); Palmiter, supra note 121, at 879, 885 (observing that the SEC promulgated the shareholder proposal rule to catalyze a "corporate democracy" but "[s]tanding in the way of the rule's purposes is the SEC's attempt to channel the shareholder-management dialogue through a regime of administrative licensing of corporate speech").

SEC has adopted rules that regulate voting by institutional intermediaries by making clear that these "investment advisers" have a fiduciary duty to exercise votes to further their investors' interests.[122] This requirement has been interpreted by scholars and institutional investors alike as requiring a profit motive for voting decisions and limiting action by investment advisers to strategies aimed at obtaining risk-adjusted returns for beneficiaries, not benefits for stakeholders or the general public.[123]

An even more dramatic example of SEC action taken to benefit shareholders, and specifically to expand shareholder voice, is proxy access. In 2010, the SEC passed—in "a close vote along partisan lines"—a rule that would grant shareholders the ability to add director nominees to the company's proxy.[124] But the rule was swiftly challenged in court by the Business Roundtable and the Chamber of Commerce, who argued that the rule would distract directors and management from the performance of their responsibilities and result in a loss in shareholder value.[125] Ultimately, the D.C. Circuit overturned the rule,[126] leaving the choice to shareholders who could submit proposals to urge companies to adopt proxy access bylaws.[127]

As the proxy access episode reveals, the SEC's path toward fulfilling its mission is not without controversy, and the agency has become increasingly politicized.[128] But as section II.C.3 discusses, shareholder primacy has become enmeshed across both sides of the political aisle, indicating that increased polarization is unlikely to meaningfully change the agency's shareholderist orientation. Indeed, even pro-management action that is typically supported by Republican appointees tends to be described as benefitting shareholders. For example, the SEC has proposed rules that would substantially raise the ownership thresholds and outcome hurdles for

122. Rules and Regulations, Investment Advisers Act of 1940, 17 C.F.R. § 275.206(4)-6.

123. See, e.g., Bernard S. Sharfman, How the SEC Can Help Mitigate the "Proactive" Agency Costs of Agency Capitalism, 8 Am. U. Bus. L. Rev. 1, 6–7 (2019) (discussing the SEC proxy voting rule and stating that "the objective of this fiduciary duty is shareholder wealth maximization"); infra section II.B.1.

124. Marcel Kahan & Edward Rock, The Insignificance of Proxy Access, 97 Va. L. Rev. 1347, 1351 (2011).

125. Reply Brief of Petitioners Business Roundtable and Chamber of Commerce of the United States of America at 8–9, Bus. Roundtable v. Sec. & Exch. Comm'n, 647 F.3d 1144 (D.C. Cir. 2011) (No. 10-1305), 2011 WL 2014801.

126. Bus. Roundtable v. Sec. & Exch. Comm'n, 647 F.3d 1144, 1146 (D.C. Cir. 2011).

127. See Am. Fed'n of State, Cnty. & Mun. Emps. v. Am. Int'l Grp., 462 F.3d 121, 123 (2d Cir. 2006) (holding that Rule 14-8 did not exclude proxy access bylaw shareholder proposals). After that decision was issued, the SEC amended Rule 14-8 to overrule it, but in 2010, the agency reversed course, adopting a new Rule 14a-8 that would permit shareholders to bring proxy access bylaw proposals under certain circumstances. See Reacting to Shareholder Proxy Access Proposals, Reed Smith (Oct. 10, 2011), https://www.reedsmith.com/en/perspectives/2011/10/reacting-to-shareholder-proxy-access-proposals [https://perma.cc/8JSG-AE7H].

128. See, e.g., Joseph Engelberg, Matthew Henriksson, Asaf Manela & Jared Williams, The Partisanship of Financial Regulators 4 (2021), https://ssrn.com/abstract=3481564 [https://perma.cc/3CFG-9C45] (unpublished manuscript).

shareholder proposal submissions and resubmissions.[129] Critics observed that the new rules impede small retail shareholders from submitting proposals and may insulate management from accountability.[130] The SEC nonetheless couched the legal reform as advancing shareholder interests—reflecting that even when the agency gives management a victory, it often does so in the language of a shareholderist regulatory agenda.[131]

4. *Department of Labor.* — Just as the SEC regulates investor conduct, so does the DOL, the federal agency with regulatory oversight over retirement accounts in the United States.[132] Specifically, the DOL sets standards of conduct for public and private pension funds subject to the Employment Retirement Income Security Act (ERISA).[133] These funds manage trillions of dollars on behalf of U.S. employees and invest much of it in the stock market.[134] Importantly, ERISA imposes a fiduciary duty on investment advisers that invest pension fund assets, and the agency has interpreted this requirement as imposing a duty to maximize the plan's financial value.[135]

As clear proof of this orientation, the agency once finalized a rule that prohibited plan fiduciaries from selecting plan assets based on nonfinancial objectives.[136] The rule specifically targeted ESG investment vehicles: The news release announcing the proposed rule stated that "[t]he proposal is designed, in part, to make clear that ERISA plan

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129. Press Release, SEC, SEC Proposes Rule Amendments to Improve Accuracy and Transparency of Proxy Voting Advice (Nov. 5, 2019), https://www.sec.gov/news/press-release/2019-231 [https://perma.cc/YL6Q-HY74].

130. See Kobi Kastiel & Yaron Nili, The Giant Shadow of Corporate Gadflies, 94 S. Cal. L. Rev. 569, 619–23 (2021) (discussing how changes to shareholder proposal rules may impact the role played by "gadflies or other individuals" as "governance facilitators"); Robert J. Jackson Jr., Comm'r, SEC, Statement on Proposals to Restrict Shareholder Voting (Nov. 5, 2019), https://www.sec.gov/news/public-statement/statement-jackson-2019-11-05-open-meeting [https://perma.cc/PZV6-LQYX] (noting that the proposal "adopt[s] pro-management changes that swat a gadfly with a sledgehammer" and may "insulate corporate managers from accountability").

131. See, e.g., Procedural Requirements and Resubmission Under Exchange Act Rule 14a-8, 84 Fed. Reg. 66,458, 66,503 (proposed Dec. 4, 2019) (justifying elevated resubmission hurdles as benefitting shareholders by, among other things, allowing them "to focus on the processing of proposals that may garner higher levels of voting support").

132. See Summary of the Major Laws of the Department of Labor, DOL, https://www.dol.gov/general/aboutdol/majorlaws [https://perma.cc/RK9Y-KWXK] (last visited Aug. 9, 2021).

133. See id.

134. Heather Gillers, Public Pension Plans Continue to Shift Into U.S. Stocks, Wall St. J. (Nov. 5, 2019), https://www.wsj.com/articles/public-pension-plans-continue-to-shift-into-u-s-stocks-11572955200 (on file with the *Columbia Law Review*); F. Norrestad, Total Assets of Pension Funds in the United States From 2009 to 2019, Statista (Dec. 7, 2020), https://www.statista.com/statistics/421729/pension-fundsassets-usa [https://perma.cc/N8WA-M33Z].

135. 29 C.F.R. § 2550.404a-1 (2020); see also Max M. Schanzenbach & Robert H. Sitkoff, Reconciling Fiduciary Duty and Social Conscience: The Law and Economics of ESG Investing by a Trustee, 72 Stan. L. Rev. 381, 407 (2020).

136. 29 C.F.R. §§ 2509, 2550.

fiduciaries may not invest in ESG vehicles when they understand an underlying investment strategy of the vehicle is to subordinate return or increase risk for the purpose of nonfinancial objectives."[137] In other words, the agency adopted a particularly stringent form of shareholder primacy, requiring plan fiduciaries to have an "unwavering focus" on pecuniary goals and removing discretion to consider noneconomic shareholder value more broadly.[138] Since then, the DOL under a new administration has proposed to amend the rule to allow more leeway for fiduciaries to consider ESG factors, but even these revised rules emphasize the financial interests of investors as the lodestar.[139] Ultimately, this example is particularly revealing because it again shows how government policy not only facilitates the aggregation of governance power in the hands of influential investors but also influences how that money is invested and how governance rights are exercised.[140]

In sum, this section explores the main actors that create corporate law and regulate the business affairs of corporations: Delaware, Congress, the SEC, and the DOL. Each of these actors interacts in a dynamic way, influencing aspects of corporate behavior in tandem (and some would say, in competition with each other[141]), generally toward the benefit of shareholders. And as the next section reveals, the legal components of the machine also shape its institutional components, bolstering their shareholderist orientation.

B. *Institutions*

Corporate governance is not only a creature of law but also of markets and institutions. In this section, we focus on the institutional players that participate in the market for corporate governance—i.e., that are responsible for shaping the body of extralegal rules and norms that powerfully shape corporate behavior. These institutions are influenced by the legal

137. Press Release, DOL, U.S. Department of Labor Proposes New Investment Duties Rule (June 23, 2020), https://www.dol.gov/newsroom/releases/ebsa/ebsa20200623 [https://perma.cc/DD7D-WFJ8] [hereinafter DOL, New Investment Duties Rule].

138. Id.; see also Lipton, Shareholder Primacy, supra note 13, at 889–90 (discussing how the Bush and Trump Administrations promulgated guidance advising that ERISA trustees should avoid consideration of ESG factors whereas the Obama Administration granted more discretion).

139. Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights, 86 Fed. Reg. 57,272 (proposed Oct. 14, 2021) (to be codified at 29 C.F.R. pt. 2550) ("The Department is concerned that . . . current regulation may deter fiduciaries from taking steps that other marketplace investors would take in enhancing investment value and performance, or improving investment portfolio resilience against the potential financial risks and impacts often associated with climate change and other ESG factors.").

140. See Lipton, Beyond Internal and External, supra note 87, at 688 ("[T]he existence of different types of investors, their preferences with respect to corporate behavior, their risk tolerance, and their time horizons, are all at least partially a product of regulatory choice.").

141. See Roe, Delaware's Competition, supra note 100, at 592.

regime described above, and they in turn provide far-reaching influence over corporate affairs. In this section, we describe the many institutional players in the corporate governance industry and their role in focusing company attention on shareholder interests.

1. *Influential Investors.* — Today's institutional investors are more powerful than ever before. As a result of capital market concentration, the largest shareholders in most public companies are investment intermediaries with the heft and sophistication to wield their governance power to advance shareholder interests.[142] Although these intermediaries vary in their level of engagement and investment strategy, all put further pressure on management to focus on shareholder value. Before describing this dynamic in more detail, we observe that the rise of powerful investors has been a key driver of the corporate governance machine's shareholderist orientation and has spurred the development of ancillary institutions that further promote shareholder interests.

Historically, only a subset of institutional shareholders—hedge funds and pension funds—played a significant role in shareholder activism.[143] Hedge fund activists generally use their governance rights to induce the targeted company to maximize shareholder wealth and marshal support from other shareholders to this cause.[144] Of course, this role is not without controversy, as some critics view their activism as harming long-term shareholder value—but note, again, that even this dominant form of criticism takes shareholder value as the lodestar.[145] Pension funds, and public pension funds in particular, are also active shareholders,[146] although their incentives and objectives are less clear cut—on the one hand, federal guidance suggests their fiduciary duty requires pursuing economic value for

142. See, e.g., John C. Coates, The Future of Corporate Governance Part I: The Problem of Twelve 2 (Harv. Pub. L., Working Paper No. 19-07, 2018), https://ssrn.com/abstract=3247337 [https://perma.cc/AD6U-B6CB] (discussing how "control of most public companies – that is the wealthiest organizations in the world, with more revenue than most states – will soon be concentrated in the hands of a dozen or fewer [institutions]").

143. See Bernard S. Black, Shareholder Passivity Reexamined, 89 Mich. L. Rev. 520, 570 (1990); Rock, Shareholder-Centric Reality, supra note 83, at 1922.

144. Marcel Kahan & Edward B. Rock, Hedge Funds in Corporate Governance and Corporate Control, 155 U. Pa. L. Rev. 1021, 1029, 1064 (2007).

145. See, e.g., John C. Coffee, Jr. & Darius Palia, The Wolf at the Door: The Impact of Hedge Fund Activism on Corporate Governance, 41 J. Corp. L. 545, 585–586 (2016).

146. See, e.g., Stewart J. Schwab & Randall S. Thomas, Realigning Corporate Governance: Shareholder Activism by Labor Unions, 96 Mich. L. Rev. 1018, 1019–20 (1998) ("[L]abor activism is a model for any large institutional investor attempting to maximize return on capital.").

plan participants;[147] on the other, those participants are generally employees whose interests may conflict with shareholders more broadly.[148]

Over the past decade, hedge funds and pension funds have remained active, but the most notable trend has been the rising influence of mutual funds. Today, the mutual fund giants—Vanguard, BlackRock, and State Street, or the so called "Big Three"—together hold over 20% of the equity of S&P 500 companies.[149] And these powerful shareholders have begun to articulate a broader view of fiduciary responsibility and corporate purpose. For example, in a 2018 public letter to company CEOs, BlackRock CEO Larry Fink explained: "To prosper over time, every company must not only deliver financial performance, but also show how it makes a positive contribution to society. Companies must benefit all of their stakeholders, including shareholders, employees, customers, and the communities in which they operate."[150] This statement was celebrated as an embrace by one of the world's largest investors of a stakeholder model and an abandonment of shareholder primacy.[151]

But a closer look reveals that Fink's letter is squarely aligned with the pursuit of shareholder value and economic return in particular. In a subsequent letter, Fink explained that "profits and purpose are inextricably linked. Profits are essential if a company is to effectively serve all of its stakeholders over time . . . . Similarly, when a company truly understands and expresses its purpose, it functions with the focus and strategic discipline that drive long-term profitability."[152]

The Big Three's voting guidelines further illustrate the link between their governance initiatives and shareholder value. For example, Vanguard explains: "We believe that good governance practices—thoughtful board composition, effective oversight of company strategy and

147. See, e.g., DOL, New Investment Duties Rule, supra note 138; see also David Webber, The Rise of the Working-Class Shareholder: Labor's Last Best Weapon, at xii, 43–44 (2018) (discussing "the massive growth of worker pension funds" and their shareholder activism "to make corporate managers more accountable to long-term shareholders").

148. See Roberta Romano, Public Pension Fund Activism in Corporate Governance Reconsidered, 93 Colum. L. Rev. 795, 796 (1993) (arguing that public pension fund managers face "considerable political pressure to temper investment policies with local considerations, such as fostering in-state employment, which are not aimed at maximizing the value of their portfolios' assets") [hereinafter Romano, Public Pension Fund Activism].

149. Lucian Bebchuk & Scott Hirst, The Specter of the Giant Three, 99 B.U. L. Rev. 721, 724, 734 fig.1 (2019) ("The average combined stake in S&P 500 companies held by the Big Three essentially quadrupled over the past two decades, from 5.2% in 1998 to 20.5% in 2017 . . . .").

150. Letter from Larry Fink, Chairman & Chief Exec. Officer, BlackRock, Inc., to Chief Exec. Officers 1 (2018), https://www.blackrock.com/corporate/investor-relations/2018-larry-fink-ceo-letter [https://perma.cc/W2E3-ML9F].

151. See, e.g., David J. Berger, Reconsidering Stockholder Primacy in an Era of Corporate Purpose, 74 Bus. Law. 659, 662–63 (2019).

152. Letter from Larry Fink, Chairman & Chief Exec. Officer, BlackRock, Inc., to Chief Exec. Officers 1 (2019), https://www.blackrock.com/americas-offshore/en/2019-larry-fink-ceo-letter [https://perma.cc/2DER-UJQR].

risks, aligned pay for performance, and strong provisions to empower shareholders—are the foundation on which a company's board of directors can build enduring shareholder value."[153] Likewise, BlackRock explains: "Our engagement priorities promote sound corporate governance and business practices that are consistent with sustainable long-term financial returns."[154] And finally, State Street explains that it prioritizes ESG issues that will have "the most material impacts on the long-term value of our portfolio companies."[155] In sum, while some of these institutional investors have begun to highlight the importance of stakeholder interests, there is no sign that they have abandoned the pursuit of long-term shareholder value.[156] Rather than indicate a sharp turn toward stakeholder capitalism, Fink's statements may instead reflect an enlightened approach to shareholderism that views consideration of stakeholder welfare as a means of sustainably achieving value for shareholders.[157]

We should not be surprised that institutional investors reinforce a shareholder primacy viewpoint, even while championing an enlightened perspective. For one, like pension funds, mutual funds have a fiduciary duty to act in the best interests of their clients, and as discussed, this duty has been interpreted as requiring wealth maximization.[158] Not only that, institutional shareholders will pursue financial performance so long as that is the metric by which their customers evaluate them.

2. *Investor Associations.* — Influential investors exert pressure not only on their own but also in coordination with other investors via associations. The most well-known investor association is the Council of Institutional

153. Vanguard, Investment Stewardship: 2019 Annual Report 1 (2019), https://about.vanguard.com/investment-stewardship/perspectives-and-commentary/2019_investment_stewardship_annual_report.pdf [https://perma.cc/352K-TUBV].

154. Investment Stewardship, BlackRock, https://www.blackrock.com/sa/professional/en/about-us/investment-stewardship [https://perma.cc/LE67-QJ5G] (last visited Aug. 26, 2021).

155. Asset Stewardship, State St. Glob. Advisors, https://www.ssga.com/us/en/individual/mf/capabilities/esg/asset-stewardship (on file with the *Columbia Law Review*) (last visited Aug. 26, 2021).

156. An incentive to maximize long-term portfolio value could also help explain emphasis on sustainability and stakeholders. See John Armour & Jeffrey N. Gordon, Systemic Harms and Shareholder Value, 6 J. Legal Analysis 35, 39 (2014) ("[S]hare price maximization can in the presence of systemic externalities lead to reduced portfolio returns to investors."); Condon, supra note 15, at 5 (explaining institutional investor support of climate activism by framing value maximization at portfolio rather than firm level).

157. Another possibility is that this activity may represent a savvy marketing campaign designed to convince investors that by choosing a BlackRock fund, they can have it all—wealth maximization and a social impact. See, e.g., Michal Barzuza, Quinn Curtis & David H. Webber, Shareholder Value(s): Index Fund Activism and the New Millennial Corporate Governance, 93 S. Cal. L. Rev. 1243, 1249–51 (2021) (arguing that index funds are competing for investments from millennials who place a premium on social values).

158. See Investment Adviser Codes of Ethics, Investor Advisers Act Release No. 2256, 69 Fed. Reg. 41,696, 41,696 (July 9, 2004); Hart & Zingales, supra note 17.

Investors (CII).[159] Founded in 1985, CII espouses the goal of advancing "strong governance standards at public companies and strong shareholder rights."[160] Today, its membership includes more than 140 asset managers, including public pension funds, corporate and labor funds, foundations, and endowments, with combined assets under management of $39 trillion.[161] The association's website boasts that "institutional shareowners have a much greater voice today than they did in 1985 in part because of the constant vigilance and hard work of CII to protect and strengthen that voice."[162]

How does CII strengthen shareholder voice? In coordination with its members, the organization has developed an extensive body of policies that embrace accountability to shareholders[163] and shareholder participation in governance.[164] The organization pursues all avenues to gain adherence to these goals—it "advocates vigorously for CII policies via speeches, reports, letters and testimony."[165] For example, in response to the Business Roundtable's revised statement in favor of running companies "for the benefit of all stakeholders," the CII responded publicly with a sharp rebuttal that companies must "sustain a focus on long-term shareholder value"

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159. Although CII is the most prominent investor advocacy group, others exert influence. For example, the Investor Stewardship Group represents sixteen investor members with $17 trillion in assets under management. About the Investor Stewardship Group and the Framework for U.S. Stewardship and Governance, Inv. Stewardship Grp., https://isgframework.org [https://perma.cc/GX3N-95JR] (last visited Aug. 9, 2021). That group has outlined a "stewardship code" for U.S. companies with six main principles, including "[b]oards are accountable to shareholders" and "[b]oards should be responsive to shareholders." Abe M. Friedman, Investor Coalition Publishes U.S. Stewardship Code, Harv. L. Sch. F. on Corp. Governance (Feb. 9, 2017), https://corpgov.law.harvard.edu/2017/02/09/investor-coalition-publishes-u-s-stewardship-code/ [https://perma.cc/RQ6V-UM2W].

160. About CII, Council of Institutional Invs., https://www.cii.org/about [https://perma.cc/Y38T-4WHW] (last visited Aug. 9, 2021).

161. Id.

162. Id.

163. Policies on Corporate Governance, Council of Institutional Invs., https://www.cii.org/corp_gov_policies [https://perma.cc/N47H-BGJY] (last visited Aug. 9, 2021) ("Corporate governance structures and practices should protect and enhance a company's accountability to its shareowners . . . .").

164. Id. ("Shareowners should have meaningful ability to participate in and vote on the major fundamental decisions that affect corporate viability, and meaningful opportunities to suggest or nominate director candidates and to suggest processes and criteria for director selection and evaluation."); see also Tim C. Opler & Jonathan S. Sokobin, Does Coordinated Institutional Activism Work?: An Analysis of the Activities of the Council of Institutional Investors 4–5 (Dice Ctr. for Rsch. in Fin. Econ., Working Paper No. 95-5, 1996), https://ssrn.com/abstract=46880 [https://perma.cc/QJP3-876S] (discussing how CII provided a forum for public and private pension funds to coordinate shareholder activism).

165. Issues & Advocacy, Council of Institutional Invs., https://www.cii.org/issues_advocacy [https://perma.cc/C7WA-UVRS] [hereinafter CII, Issues and Advocacy] (last visited Aug. 9, 2021).

and operate with "clear accountability to company owners."[166] In addition to this kind of public advocacy, CII staff and members also engage directly with "corporate managers and directors, stock exchange officials, regulators and policymakers."[167]

As the CII example reveals, investor advocacy groups help enshrine a shareholder primacy viewpoint. To secure broad participation, the groups adopt principles that they frame as shared in common with institutional investors. And once investors have signed on, the groups have powerful leverage to influence company behavior to further shareholder interests.

3. *Industry Associations.* — Institutional investors are not the only entities that work in association to advance their interests; corporate executives do too.[168] And some of these industry associations are active participants in the corporate governance machine, engaging in advocacy on issues related to governance and often pushing pro-management positions with the claimed objective of serving shareholder interests.

The Business Roundtable, an association of CEOs of large U.S. public companies, is one of the most prominent industry associations. In 2019, the Business Roundtable revised its standing statement that "corporations exist principally to serve their shareholders."[169] Specifically, the organization issued a press release announcing the signatories' commitment to running companies "for the benefit of all stakeholders—customers, employees, suppliers, communities and shareholders."[170] But instead of providing a full embrace of stakeholderism, the statement framed its new commitment to stakeholders as a means of "[g]enerating long-term value for shareholders."[171] And even this incremental reframing generated a hostile response from many, including investor associations (CII among them) and academics who responded with a defense of shareholder primacy.[172]

166. Press Release, Council of Institutional Invs., Council of Institutional Investors Responds to Business Roundtable Statement on Corporate Purpose (Aug. 19, 2019), https://www.cii.org/aug19_brt_response [https://perma.cc/V9U3-QMPA] [hereinafter CII Response].

167. CII, Issues and Advocacy, supra note 166.

168. Lee Drutman, The Business of America Is Lobbying: How Corporations Became Politicized and Politics Became More Corporate 98 (2015).

169. David Gelles & David Yaffe-Bellany, Shareholder Value Is No Longer Everything, Top C.E.O.s Say, N.Y. Times (Aug. 20, 2019), https://www.nytimes.com/2019/08/19/business/business-roundtable-ceos-corporations.html (on file with the *Columbia Law Review*).

170. Press Release, Bus. Roundtable, Business Roundtable Redefines the Purpose of a Corporation to Promote 'An Economy That Serves All Americans' (Aug. 19, 2019), https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans [https://perma.cc/3B7C-ZGVJ].

171. Statement on the Purpose of a Corporation, Bus. Roundtable (Aug. 19, 2019), https://s3.amazonaws.com/brt.org/BRT-StatementonthePurposeofaCorporationJuly2021.pdf [https://perma.cc/9YHL-CKHX].

172. See, e.g., Bebchuk & Tallarita, supra note 4, at 1–4; Jesse Fried, Shareholders Always Come First and That's a Good Thing, Fin. Times (Oct. 7, 2019),

Other industry associations have taken positions with even stronger claims about serving shareholder interests. For example, the National Association of Manufacturers launched "The Main Street Investors' Coalition," and lobbied the SEC to make it harder for shareholders to submit proposals. The organization claimed its motivation was to advance the interests of "main street investors" whose voices had been drowned out by large institutional shareholders.[173]

Why would industry associations prioritize shareholder interests? The answer, we believe, is that they generally don't; instead, it appears that corporate managers pursue their own interests by touting shareholder welfare as a way to attract broad support for reforms that increase management power and insulation. As the Main Street Investors' Coalition example reveals, when management is faced with unwanted pressure from vocal groups of shareholders, business associations may seek reform that minimizes their voice, in the guise of protecting shareholders at large. More broadly, these examples reflect a pattern of industry associations working within the corporate governance machine to achieve their aims, even when those aims run directly counter to the machine's pro-shareholder orientation.

4. *Proxy Advisors.* — Proxy advisors are an important recent addition to the corporate governance machine.[174] These private companies collect information, analyze corporate elections, and provide voting recommendations to clients for a fee.[175] And as the stock market has consolidated in the hands of institutional investors, the proxy advisors that advise them have gained in power and influence.[176] Institutional investors hold approximately 80% of public company shares, but their structure and financial model limits their ability to research and cast informed votes on all matters without incurring significant costs, thus opening the door for proxy advisors to help guide their voting decisions.[177] Consider the mutual fund company Vanguard, which cast approximately 170,000 votes for over 13,000

https://www.ft.com/content/fff170a0-e5e0-11e9-b8e0-026e07cbe5b4 (on file with the *Columbia Law Review*); CII Response, supra note 167.

173. Leading National Associations Announce Launch of First-of-Its-Kind Investor Coalition, PR Newswire (May 22, 2018), https://www.prnewswire.com/news-releases/leading-national-associations-announce-launch-of-first-of-its-kind-investor-coalition-300652366.html [https://perma.cc/X75V-H4JE].

174. See Stephen Choi, Jill E. Fisch & Marcel Kahan, The Power of Proxy Advisors: Myth or Reality?, 59 Emory L.J. 869, 870 (2010).

175. Id. at 870–71.

176. This reality is compounded by the fact that the DOL and SEC urge institutional investors to vote all the proxies of their portfolio company investments. See Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies, 68 Fed. Reg. 6564, 6565 (Feb. 7, 2003) (codified at 17 C.F.R. pts. 239, 249, 270, 274); Letter from Alan D. Lebowitz, Deputy Assistant Sec'y, DOL, to Helmuth Fandl, Chairman of Ret. Bd., Avon Prods., Inc., DOL Interpretive Letter on Avon Products, Inc. Employees' Retirement Plan, 1988 WL 897696, at *2 (Feb. 23, 1988).

177. See Jill E. Fisch, Assaf Hamdani & Steven Davidoff Solomon, The New Titans of Wall Street: A Theoretical Framework for Passive Investors, 168 U. Pa. L. Rev. 17, 46, 50–51

portfolio companies in one recent year.[178] To accomplish this task, the institution often relies on two proxy advisors: Institutional Shareholder Services (ISS) and Glass Lewis & Co.[179] Other large institutional investors generally do the same.[180] As a result, the two dominant proxy advisor firms wield ample power in corporate elections, shifting a significant percentage of shareholder votes.[181]

Because proxy advisors supply voting advice on thousands of different companies each year, they are forced to be generalists on a wide range of governance issues that commonly arise, ranging from proxy access to corporate political spending disclosures.[182] To supply advice at scale, they reach conclusions about "best practices" on each issue and then set governance guidelines that are enforced through their voting guidance.[183] As a result, proxy advisors influence not only investor voting but also board

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(2019); Dorothy S. Lund, The Case Against Passive Shareholder Voting, 43 J. Corp. L. 493, 516 (2018) [hereinafter Lund, Against Passive Shareholder Voting]; BlackRock, BlackRock Investment Stewardship: Protecting Our Clients' Assets for the Long-Term 13 (2020), https://www.blackrock.com/corporate/literature/publication/blk-profile-of-blackrock-investment-stewardship-team-work.pdf [https://perma.cc/V7BR-QFJB] [hereinafter BlackRock, Investment Stewardship] ("[I]n most markets we subscribe to two research providers.").

178. Vanguard, supra note 154, at 8.

179. See Ryan Bubb & Emiliano Catan, The Party Structure of Mutual Funds 2 (Eur. Corp. Governance Inst., Law Working Paper No. 560/2020, 2020), https://ssrn.com/abstract=3124039 [https://perma.cc/8A4N-7W3R] (showing that recommendations from the two leading proxy advisors heavily influence mutual fund voting).

180. Joseph A. McCahery, Zacharias Sautner & Laura T. Starks, Behind the Scenes: The Corporate Governance Preferences of Institutional Investors, 71 J. Fin. 2905, 2928 (2016) (finding that a majority of institutional investor respondents agreed that proxy advisors help them make informed voting decisions); BlackRock, Investment Stewardship, supra note 178.

181. Choi et al., supra note 175, at 906 (estimating that an ISS recommendation shifts 6%–10% of the shareholder votes); McCahery et al., supra note 181, at 2928 (finding that "proxy advisors do not just aggregate shareholder preferences or coincide with them, but actually influence voting decisions"); Timothy M. Doyle, Am. Council for Cap. Formation, The Realities of Robo-Voting 6 (2018), http://accfcorpgov.org/wp-content/uploads/ACCF-RoboVoting-Report_11_8_FINAL.pdf [https://perma.cc/BU5G-ZCGJ] (estimating ISS influence as being "between 6–11% and up to 25%"); David F. Larcker, Brian Tayan & James R. Copland, The Big Thumb on the Scale: An Overview of the Proxy Advisory Industry, Harv. L. Sch. F. on Corp. Governance (June 14, 2018), https://corpgov.law.harvard.edu/2018/06/14/the-big-thumb-on-the-scale-an-overview-of-the-proxy-advisory-industry/ [https://perma.cc/LVX6-47WJ] (discussing studies finding that proxy advisors can influence up to 30% of shareholder voting).

182. See Nadya Malenko & Yao Shen, The Role of Proxy Advisory Firms: Evidence From a Regression-Discontinuity Design, 29 Rev. Fin. Stud. 3394, 3394–96 (2016) (noting that ISS "covers almost 40,000 meetings in 115 countries and has over 1,600 institutional clients" and has used a quantitative methodology for determining the level of analysis to give a company's say-on-pay proposal).

183. Id.; David F. Larcker, Allan L. McCall & Brian Tayan, Stanford Closer Look Series, And Then a Miracle Happens!: How Do Proxy Advisory Firms Develop Their Voting Recommendations? 1 (2013), https://www.gsb.stanford.edu/sites/gsb/files/publication-pdf/cgri-closer-look-31-proxy-firms-voting-recommendations.pdf (on file with the *Columbia Law Review*).

and management behavior before the corporate proxy even arrives: Many companies proactively adopt governance policies that mesh with ISS and Glass Lewis recommendations and sometimes even seek their behind-the-scenes consulting advice on executive compensation packages and management-sponsored proposals to increase the likelihood that shareholders will approve them.[184]

What do these influential advisors recommend? A perusal of ISS's voting principles reveals that shareholder primacy is deeply ingrained in its policies. For example, its principles state that ISS aims to promote "long-term shareholder value creation" and encourage practices that respect shareholder rights.[185] The guidelines further explain that "boards should be accountable to shareholders, the owners of the companies," "shareholders should have meaningful rights on structural provisions," and "boards should be sufficiently independent so as to ensure that they are able and motivated to effectively supervise management[] . . . for the benefit of all shareholders."[186] Likewise, Glass Lewis's policies explain that the purpose of its proxy research is to "facilitate shareholder voting in favor of governance structures that will . . . create shareholder value."[187]

It is unsurprising that proxy advisors would proclaim a commitment to shareholder value because this is what their institutional investor clients generally believe they are duty-bound to pursue.[188] And even when proxy advisors offer advice relevant to stakeholder interests, those guidelines do not abandon a shareholder primacy viewpoint. Instead, proxy advisor ESG guidelines generally seek to "align responsible investment policies and practices with shareholder interests."[189] This orientation is generally consistent with the voting guidelines of many large institutional investors and

184. See, e.g., David F. Larcker, Allan L. McCall & Gaizka Ormazabal, Outsourcing Shareholder Voting to Proxy Advisory Firms, 58 J.L. & Econ. 173, 175–79 (2015) [hereinafter Larcker et al., Outsourcing Shareholder Voting]. In addition, in 2020, the SEC approved new rules that require proxy firms to provide their research to companies at the same time as their investor clients and to share rebuttals to their advice from executives. Exemptions From the Proxy Rules for Proxy Voting Advice, Exchange Act Release No. 89372, 85 Fed. Reg. 55,082 (July 22, 2020).

185. ISS Global Voting Principles, ISS, https://www.issgovernance.com/policy-gateway/iss-global-voting-principles [https://perma.cc/73RN-KNRA] (last visited Aug. 9, 2021).

186. Id.

187. Glass Lewis, 2020 Guidelines: An Overview of the Glass Lewis Approach to Proxy Advice for the United States 3 (2020), https://www.glasslewis.com/wp-content/uploads/2016/11/Guidelines_US.pdf [https://perma.cc/65RY-QTVV].

188. See Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies, Securities Act Release No. 8188, Exchange Act Release No. 47,304, Investment Company Act Release No. 25,922, 68 Fed. Reg. 6564, 6565 (Feb. 7, 2003) ("Mutual funds are formed as corporations or business trusts under state law and, as in the case of other corporations and trusts, must be operated for the benefit of their shareholders."); Schanzenbach & Sitkoff, supra note 136 (discussing the fiduciary duties of trustees of pension funds in relation to the use of ESG factors).

189. ISS ESG, Responsible Investment Solutions, https://www.issgovernance.com/file/products/sheet-iss-esg.pdf [https://perma.cc/TFB6-M94K] (last visited Mar. 2, 2020).

may help explain why many ESG-oriented funds often vote against environmental and social shareholder proposals, just like the shareholder value–oriented funds in the institution.[190] Ultimately, the principal goal of proxy advisor advice is to render management more accountable to shareholder interests, which makes it difficult to pursue stakeholder welfare whenever doing so conflicts with shareholder value maximization.

5. *Stock Exchanges.* — Stock exchanges represent another source of corporate governance. For example, the New York Stock Exchange (NYSE) is the world's largest stock exchange, and it creates many corporate governance rules that apply to its 2,800 listed companies.[191] These detailed rules influence the conduct of those companies, and they have a distinct shareholder primacy flavor. As the NYSE explained in its corporate governance guide, "companies need corporate governance policies that place the interests of their shareholders first."[192] As such, the stock exchange requires corporate boards to have a majority of independent directors and key committees populated by only these independent directors.[193] In addition, the exchange mandates a say-on-pay shareholder vote.[194] Compliance with these standards is enforced by a division of the exchange known as NYSE Regulation (NYSER); the organization can enforce violations with penalties or delisting.[195] The NYSE's closest competitor, the Nasdaq Stock Market, follows a similar approach.[196]

What motivates the NYSE and Nasdaq to adopt these rules? The stock exchanges are public companies themselves and tend to follow the

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190. See Caleb N. Griffin, Environmental and Social Voting at Index Funds, 44 Del. J. Corp. L. 167, 167 (2020) (demonstrating that "despite a considerable marketing focus on their E&S efforts, overall support for E&S proposals is low at the Big Three"); Jackie Cook & Jon Hale, 2019 ESG Proxy Voting Trends by 50 U.S. Fund Families, Harv. L. Sch. F. on Corp. Governance (Mar. 23, 2020), https://corpgov.law.harvard.edu/2020/03/23/2019-esg-proxy-voting-trends-by-50-u-s-fund-families/#4 [https://perma.cc/Z4WQ-QZDB] (describing how asset managers operationalize voting strategies and providing summary voting data on ESG shareholder proposals); Patrick Temple-West, Big US Sustainable Funds Fail to Support ESG Shareholder Proposals, Fin. Times (Sept. 7, 2019), https://www.ft.com/content/5d342a5d-443d-3327-9502-2361f37f251c (on file with the *Columbia Law Review*) (noting that "funds labelled by BlackRock, JPMorgan Asset Management and Vanguard as sustainable frequently sided with a company's management and against shareholder proposals on [ESG-related] issues").

191. Kristin N. Johnson, Regulating Innovation: High Frequency Trading in Dark Pools, 42 J. Corp. L. 833, 839 (2017).

192. Tom Farley, Foreword, *in* NYSE: Corporate Governance Guide, at vi, vi (Steven A. Rosenblum, Karessa L. Cain & Sabastian V. Niles eds., 2014).

193. Glenn H. Booraem, An Institutional Investor's Viewpoint on Corporate Governance, *in* NYSE: Corporate Governance Guide, supra note 193, at 13, 14.

194. Id.

195. See NYSE Disciplinary Actions, NYSE, https://www.nyse.com/regulation/disciplinary-actions [https://perma.cc/NH3N-M9SQ] (last visited Aug. 9, 2021).

196. See FAQs - Listings, Nasdaq, https://listingcenter.nasdaq.com/MaterialHome.aspx?mcd=LQ (on file with the *Columbia Law Review*) (last visited Aug. 9, 2021) (describing the Nasdaq's enforcement powers).

demands of other institutions driving the market for listings.[197] In addition, the exchanges must file their rules with the SEC for review,[198] and on occasion, Congress has mandated that the exchanges adopt certain listing standards.[199] This regulatory oversight likely contributes to the exchanges' focus on "good governance" that privileges shareholders; if the NYSE or Nasdaq drops listing standards below some perceived acceptable level, they may be subject to additional scrutiny. As a result, absent a significant shift in this regulatory agenda and dynamic, we can expect the stock exchanges will continue to regulate listed companies with an investor-focused mandate.[200]

6. *Stock Indices.* — Unlike stock exchanges, which have influenced company governance for over a century, stock indices are a more recent addition to the system. A stock index is a measurement of a section of the stock market, often used as a benchmark for actively managed mutual funds or as a baseline for passively managed mutual funds.[201] In the United States, thousands of indices exist, but three dominate the market: the S&P 500, the Dow Jones Industrial Average, and the Nasdaq Composite.[202] These three major indices are sufficiently important drivers of investor demand for company shares that their standards for inclusion can influence corporate behavior.[203]

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197. See Paul G. Mahoney, The Exchange as Regulator, 83 Va. L. Rev. 1453, 1500 (1997) ("Exchanges have strong incentives to provide rules of market structure that investors want and to compel adherence by their members to contractual and fiduciary obligations."); see also Adam C. Pritchard, Markets as Monitors: A Proposal to Replace Class Actions with Exchanges as Securities Fraud Enforcers, 85 Va. L. Rev. 925, 963–64 (1999) (explaining that "[e]xchanges serve corporations by providing liquidity for their securities" and have incentives to protect investors).

198. 17 C.F.R. § 240.19b-4 (2020); Rules - All NYSE Group Exchanges, NYSE, https://www.nyse.com/regulation/ [https://perma.cc/3L5G-LQEY] (last visited Aug. 26, 2021); see also Listing Center, Nasdaq, https://listingcenter.nasdaq.com/rulebook/Nasdaq/rules/Nasdaq-5000 [https://perma.cc/8MT6-VPSW] (last visited Aug. 11, 2021) (describing SEC oversight authority over Nasdaq listings).

199. See, e.g., Corporate Governance Issues, Including Executive Compensation Disclosure and Related SRO Rules, SEC, https://www.sec.gov/spotlight/dodd-frank/corporategovernance.shtml [https://perma.cc/A4PH-H4D8] (last visited Aug. 9, 2021).

200. See Joel Seligman, Equal Protection in Shareholder Voting Rights: The One Common Share, One Vote Controversy, 54 Geo. Wash. L. Rev. 687, 694–97 (1986).

201. Adriana Z. Robertson, The (Mis)Uses of the S&P 500, at 1 (Sept. 6, 2019), https://ssrn.com/abstract=3205235 [https://perma.cc/3YQJ-JQ7W] [hereinafter Robertson, (Mis)Uses] (unpublished manuscript).

202. There Are Now More Indexes Than Stocks, Bloomberg (May 12, 2017), https://www.bloomberg.com/news/articles/2017-05-12/there-are-now-more-indexes-than-stocks (on file with the *Columbia Law Review*).

203. Lysle Boller & Fiona M. Scott Morton, Testing the Theory of Common Stock Ownership 2 (Nat'l Bureau of Econ. Rsch., Working Paper No. 27515, 2020), https://ssrn.com/abstract=3649879 (on file with the *Columbia Law Review*) (finding that stocks entering the S&P 500 index experience a significant increase in institutional ownership and stock returns); Robertson, (Mis)Uses, supra note 202, at 2 (noting it has been recognized since at least the mid-1980s that "stocks tend to jump after being added to

Consider the S&P 500, the world's most-tracked index by assets under management that contains "500 of the top companies in leading industries of the U.S. economy."[204] Contrary to popular understanding, the construction of the index is not passive or neutral; an index committee of the S&P Dow Jones exercises significant discretion over the methodology for determining eligibility and inclusion.[205] Like the stock exchanges, the index adopts governance standards aiming to "protect the integrity and quality of [S&P's] benchmarks, and comply with applicable regulatory standards and accepted industry practices."[206]

The business model of index creators like S&P Dow Jones tells us something about their motivation in carrying out these stated goals: Their profits depend on licensing the use of their indices to asset managers for portfolio construction or fund benchmarks.[207] This logic would seem to suggest that the S&P eligibility standards would seek to eliminate poorly governed companies, as doing so should boost the performance of the index over time and increase demand for it. A misalignment, however, also exists: Regardless of actual company performance, the index provider may have an incentive to cater to the wishes of its asset manager clients so as to maximize profits from licensing fees.[208] This incentive further suggests that the governance standards adopted by indices will reflect the preferences of their clients.

Take the major indices' pushback on dual-class equity companies as an example of these incentives in action. In the wake of an increase in dual-class technology company IPOs, several major index providers, including S&P Dow Jones, declared that they would exclude dual-class companies from their indices.[209] These index providers acted despite evi-

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the S&P 500"). But see Benjamin Bennett, René M. Stulz & Zexi Wang, Does Joining the S&P 500 Index Hurt Firms? 1–5 (Fisher Coll. of Bus., Working Paper No. 2020-03-017, 2020), https://ssrn.com/abstract=3656628 [https://perma.cc/L647-N4D5] (finding that the long-run impact of index inclusion is negative).

204. Robertson, (Mis)Uses, supra note 202, at 1–4; S&P Dow Jones Indices, S&P 500 (USD) Factsheet (July 30, 2021), https://www.spglobal.com/spdji/en/indices/equity/sp-500/#overview (on file with the *Columbia Law Review*).

205. See Robertson, (Mis)Uses, supra note 202, at 1, 4, 6–8.

206. Governance, S&P Dow Jones Indices, https://www.spglobal.com/spdji/en/governance/ [https://perma.cc/U4GN-2YUB] (last visited Aug. 10, 2021).

207. Adriana Z. Robertson, Passive in Name Only: Delegated Management and "Index" Investing, 36 Yale J. on Regul. 795, 846 (2019).

208. See Scott Hirst & Kobi Kastiel, Corporate Governance by Index Exclusion, 99 B.U. L. Rev. 1229, 1246 (2019) (exploring the conflicts of interest that index providers face); Robertson, (Mis)Uses, supra note 202, at 6–7, 23 (describing the changing methodology and composition of the index and the competing client interests depending on use for index funds or benchmarks).

209. See Dorothy S. Lund, Nonvoting Shares and Efficient Corporate Governance, 71 Stan. L. Rev. 687, 692 (2019) [hereinafter Lund, Nonvoting Shares].

dence that these structures may in fact aid rather than harm firm performance.[210] Instead, the choice seems to have been a response to pressure from CII, as well as major mutual fund providers, who were concerned about the erosion of shareholder rights in the wake of Snap Inc.'s controversial public offering.[211] This example suggests that when index providers take a stand on governance issues, they are likely to supply another source of pressure in favor of their client-shareholders' interests.

7. *Ratings Agencies.* — A credit rating agency is an organization that rates companies and their securities on a scale in exchange for a fee.[212] They are substantial drivers of demand for company debt and equity products because many institutional investors are limited to purchasing investment-grade products.[213] In addition, investors generally view credit ratings as a reflection of the health of the underlying company.[214] Therefore, the models used by credit ratings providers can be quite influential.

All three major credit ratings providers—Moody's, Fitch Ratings, and S&P—integrate "good governance" criteria into their rating models.[215] A study of the corporate governance methodology used by these and two other ratings agencies found that a principal rating factor is the extent to which the company protects shareholder rights and aligns management and shareholder interests.[216] This is particularly surprising in light of the

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210. See, e.g., Scott W. Bauguess, Myron B. Slovin & Marie E. Sushka, Large Shareholder Diversification, Corporate Risk Taking, and the Benefits of Changing to Differential Voting Rights, 36 J. Banking & Fin. 1244, 1244–46 (2012) (finding superior industry-adjusted performance in connection with a change to differential voting rights and sale of insider economic interests); Valentin Dimitrov & Prem C. Jain, Recapitalization of One Class of Common Stock Into Dual-Class: Growth and Long-Run Stock Returns, 12 J. Corp. Fin. 342, 346–47 (2006) (suggesting that dual-class structures might enhance value); Ronald C. Anderson, Ezgi Ottolenghi & David M. Reeb, The Dual Class Premium: A Family Affair (Fox Sch. of Bus., Research Paper No. 17-021, 2017), https://ssrn.com/abstract=3006669 [https://perma.cc/ZDA2-599N] (finding that dual-class family firms yield excess stock returns of nearly 350 basis points per year).

211. Lund, Nonvoting Shares, supra note 210, at 691.

212. See Caitlin M. Mulligan, From AAA to F: How the Credit Rating Agencies Failed America and What Can Be Done to Protect Investors, 50 B.C. L. Rev. 1275, 1279 (2009); see also Frank Partnoy, What's (Still) Wrong With Credit Ratings?, 92 Wash. L. Rev. 1407, 1410 (2017). Research analysts serve a similar function, issuing earnings projections and providing company ratings for a fee. These analyst projections provide another source of pressure on management to maximize shareholder wealth. James J. Park, From Managers to Markets: Valuation and Shareholder Wealth Maximization 40–45, (UCLA Sch. of L., Law & Econ. Rsch. Paper No. 20-09, 2021), https://ssrn.com/abstract=3731764 [https://perma.cc/E66P-8GMU].

213. See Mulligan, supra note 213, at 1277–78. For discussions of how banks and creditors have also played a role in U.S. corporate governance, see generally Jeremy McClane, Corporate Non-Governance, 44 Del. J. Corp. L. 1 (2020); Joanna M. Shepherd, Frederick Tung & Albert H. Yoon, What Else Matters for Corporate Governance?: The Case of Bank Monitoring, 88 B.U. L. Rev. 991 (2008).

214. Mulligan, supra note 213, at 1278–79.

215. Amir Louizi & Radhouane Kammoun, Evaluation of Corporate Governance Systems by Credit Rating Agencies, 20 J. Mgmt. & Governance 363, 364 (2016).

216. Id. at 365–75.

fact that creditor and shareholder interests often diverge.[217] In addition, several credit ratings providers also offer governance grades.[218] For example, Morningstar grades companies based on "shareholder friendliness," "transparency," and a third category that asks whether firms have "consistently treated shareholders with respect."[219]

Beyond credit ratings providers, other market players offer assessments of the governance quality of an organization to aid institutional investors in their purchasing and voting decisions. For the past twenty years, the proxy advisor ISS has provided company governance ratings for a fee.[220] These ratings have undergone several name changes but are known today as the "ISS Governance QualityScore."[221] Each day, ISS announces updated scores based on four categories: Board Structure, Compensation, Shareholder Rights, and Audit & Risk Oversight. In each category, the company receives points for responsiveness to shareholders.[222] Stakeholders, by contrast, are neglected: Only once in the 199-page scoring report are stakeholders mentioned at all—in a section on accounting restatements that "pose a material risk to shareholders and/or stakeholders."[223]

There is evidence that these governance ratings, like credit ratings, substantially affect trading decisions—a recent study determined that a QualityScore downgrade by ISS has a significant negative impact on stock returns.[224] In other words, a company that wants to avoid a negative governance score and corresponding repercussions would do well to adhere to the governance guidelines adopted by ISS.[225] Therefore, these market

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217. See, e.g., Rock, Shareholder-Centric Reality, supra note 83, at 1967–78 (discussing the conflict between shareholders and creditors in anticipation of a company's looming bankruptcy).

218. Paul Rose, The Corporate Governance Industry, 32 J. Corp. L. 887, 905–06 (2007). Ratings agencies have also started to provide ESG ratings. Billy Nauman, Credit Rating Agencies Join Battle for ESG Supremacy, Fin. Times (Sept. 16, 2019), https://www.ft.com/content/59f60306-d671-11e9-8367-807ebd53ab77 (on file with the *Columbia Law Review*).

219. Rose, supra note 219, at 905; see also Stewardship Grade, Morningstar, https://www.morningstar.com/InvGlossary/stewardship_grade.aspx [https://perma.cc/Q48M-YEX6] (last visited Aug. 10, 2021).

220. Rose, supra note 219, at 900.

221. ISS ESG, Governance QualityScore: Methodology Guide 4 (2021), https://www.issgovernance.com/file/products/qualityscore-techdoc.pdf [https://perma.cc/DNM7-AN6E].

222. See id. at 13–44 (board structure); id. at 44–70 (compensation); id. at 70–94 (shareholder rights); id at. 94–104 (audit and risk oversight).

223. Id. at 96.

224. Paul M. Guest & Marco Nerino, Do Corporate Governance Ratings Change Investor Expectations? Evidence From Announcements by Institutional Shareholder Services, 24 Rev. Fin. 891, 893 (2020) (finding that rating downgrades by ISS are associated with negative announcement returns of "–1.14% over a 3-day announcement window").

225. Academics have also created influential indices that gauge governance quality, again, with a focus on shareholders as the defining feature of good governance. These include the Gompers, Ishii, and Metrick G index and the Bebchuk, Cohen, and Ferrell E

forces provide an additional source of pressure on companies to advance shareholder interests.

The previous sections explored how corporate governance is substantially influenced by various sources of law and a number of extralegal institutional players. These actors are in turn shaped by, and participate in, cultural forces—the topic we turn to next.

C. *Culture*

Culture, the final component of the corporate governance machine, may be the most influential of all.[226] Although highly contestable and notoriously hard to pin down, culture has been defined as "the total shared, learned behavior of a society or a subgroup."[227] Nobel Prize winner Oliver Williamson's model of social analysis puts culture at the very top, at the level of "social embeddedness."[228] He observes that change at this level happens slowly and that culture has a pervasive influence on the levels below, such as legal rules and company governance structures.[229] Comparative corporate governance scholars have similarly observed the important interaction between culture and law.[230] In particular, these scholars have noted how culture drives the choice of legal rules and corporate ownership structures.[231] Culture also shapes the practices adopted by institutional players, as the previous section explored.

Many informal affiliations and institutions are responsible for transmitting the culture of corporate governance in the United States, and in this section we focus on three—professional education, the media, and

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index. Merritt B. Fox, Ronald J. Gilson & Darius Palia, The Core Corporate Governance Puzzle: Contextualizing the Link to Performance, 99 B.U. L. Rev. 1995, 2035 (2019).

226. Cf. Peter A. Hall & David Soskice, Varieties of Capitalism: The Institutional Foundations of Comparative Advantage 13 (Peter A. Hall & David Soskice eds., 2001) (emphasizing "the importance of informal rules and understandings to securing the equilibria in the many strategic interactions of the political economy").

227. Margaret Mead, The Study of Culture at a Distance, *in* The Study of Culture at a Distance 3, 22 (Margaret Mead & Rhoda Métreaux eds., 1953).

228. Oliver E. Williamson, The New Institutional Economics: Taking Stock, Looking Ahead, 38 J. Econ. Literature 595, 596 (2000).

229. Id.

230. See, e.g., Amir N. Licht, Culture and Law in Corporate Governance, *in* The Oxford Handbook of Corporate Law and Governance 129, 129–58 (Jeffrey N. Gordon & Wolf-Georg Ringe eds., 2018); Amir N. Licht & Renée B. Adams, Shareholders and Stakeholders Around the World: The Role of Values, Culture and Law in Directors' Decisions 18–19 (Eur. Corp. Governance Inst., Law Working Paper No. 459/2019, 2019), https://ssrn.com/abstract=3407873 [https://perma.cc/6RCM-6HMS].

231. See, e.g., Lucian Arye Bebchuk & Mark J. Roe, A Theory of Path Dependence in Corporate Governance and Ownership, 52 Stan. L. Rev. 127, 168 (1999); Amir N. Licht, Chanan Goldschmidt & Shalom H. Schwartz, Culture, Law, and Corporate Governance, 25 Int'l Rev. L. & Econ. 229, 232–36 (2005); René M. Stulz & Rohan Williamson, Culture, Openness, and Finance, 70 J. Fin. Econ. 313, 316–21 (2003).

political associations.[232] As the following discussion reveals, each has contributed to establishing shareholder primacy as the guiding norm for fiduciary conduct.

1. *Professional Education.* — Academic institutions, particularly business and law schools, influence how future corporate fiduciaries perceive their roles. For the past few decades, these institutions have imparted the view that increasing shareholder value is the chief business objective.[233] Although it has not gone unchallenged, shareholder value "is the leitmotif of finance teaching and implicit throughout the rest of the curriculum" at most business schools.[234] In addition, legal nuances have often been lost in translation, such as when shareholder primacy is reduced to a message of maximizing short-term stock price.[235]

Researchers pinpoint this shift as starting in the 1970s, "a volatile time" for "the managerial class" as well as business schools.[236] During this time, economists and other scholars began to frame the debate in terms of agency costs and forcefully push the view that managers should focus on shareholder wealth maximization.[237] Within a decade, "business schools that had been preaching something very different since their founding days" turned toward shareholder capitalism.[238]

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232. For a broader investigation of the influence of culture on corporate governance, see Licht et al., supra note 232, at 232–36.

233. See, e.g., Darrell West, Brookings Inst., The Purpose of the Corporation in Business and Law Curricula 4 (2011), https://www.brookings.edu/wp-content/uploads/2016/06/0719_corporation_west.pdf [https://perma.cc/4TZ8-PFZB] ("The dominant 'law and economics' conception taught in many schools emphasizes profit maximization and enhancing shareholder value.").

234. N. Craig Smith & Luk Van Wassenhove, How Business Schools Lost Their Way, Bloomberg (Jan. 11, 2010), https://www.bloomberg.com/news/articles/2010-01-11/how-business-schools-lost-their-way (on file with the *Columbia Law Review*); see also Mayer, supra note 1, at 2 (noting that the "Friedman doctrine" of shareholder wealth maximization "has been the basis of business education that has moulded generations of business leaders").

235. See Rock, Debate Over Corporate Purpose, supra note 4, at 386 ("While lawyers, judges, and law professors would all explain that interpreting *Revlon* as requiring that boards maximize short-term stock price is a badly inaccurate description, many directors apparently believe it anyway."); see also Eduardo Porter, Motivating Corporations to Do Good, N.Y. Times (July 15, 2014), https://www.nytimes.com/2014/07/16/business/the-do-good-corporation.html (on file with the *Columbia Law Review*) ("Though legally dubious, the argument that it is an executive's fiduciary duty to maximize the company's share price became a mantra from the business school to the boardroom.").

236. Duff McDonald, The Golden Passport: Harvard Business School, the Limits of Capitalism, and the Moral Failure of the MBA Elite 353 (2017) (citing Harvard Business School as an example of a school that enjoyed prosperity in the 1960s before finding itself in "serious financial straits" by 1970).

237. See id. at 360–67 (discussing the introduction of "the concept of the executive as 'agent' of the company's shareholders"); see also supra section I.B (discussing the rise of agency cost theory and shareholder primacy starting in the 1970s).

238. McDonald, supra note 237, at 367; see also N. Craig Smith & David Rönnegard, Shareholder Primacy, Corporate Social Responsibility, and the Role of Business Schools, 134 J. Bus. Ethics 463, 471–73 (2016); cf. Eells, Government of Corporations, supra note 33,

As a telling example, Harvard Business School hired Michael Jensen, an early proponent of the view that minimizing agency costs between shareholders and management is a key goal of corporate governance.[239] Jensen incorporated agency theory into one of the most popular courses in the curriculum and minimized the previously dominant model that emphasized managerial discretion.[240] Others followed this approach and leading finance texts began to present shareholder value maximization as the widely accepted understanding of corporate purpose.[241] This educational focus became pervasive: A 2011 study of top law and business schools found that classes that teach the purpose of the corporation emphasize the goal of maximizing shareholder value.[242]

Not only that, around the same time, scholars in law and finance began to use event studies of stock price reactions to evaluate governance reform.[243] This development further entrenched the shareholder wealth maximization norm because a governance practice would be deemed value enhancing only if it boosted the company's share price. And scholars passed down these tenets to future business executives, who learned that governance quality is closely tied to shareholder value and profit-maximization in particular.[244]

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at vii (arguing in the 1960s that business schools should teach the "governance of corporations" so the "top business leaders of tomorrow will . . . conceive of their task in larger terms than efficient administration for production alone and accept their responsibilities as officers of private governmental systems"). A similar transformation occurred in law schools. Alexander Styhre, The Making of the Shareholder Primacy Governance Model: Price Theory, the Law and Economics School, and Corporate Law Retrenchment Advocacy, 8 Acct. Econ. & L., Jan. 2017, at 1, 24 ("[T]he contributions made by the Chicago law and economics research work . . . gradually penetrated law schools and business schools . . . .").

239. See supra notes 49–52 and accompanying text; see also Brian R. Cheffins, What Jensen and Meckling Really Said About the Public Company 3, 22 (Univ. of Cambridge Fac. of L., Legal Stud. Rsch. Paper No. 29/2020, 2020), https://ssrn.com/abstract=3679405 [https://perma.cc/VT2V-AJR3] (tracing Jensen's work and views).

240. McDonald, supra note 237, at 367.

241. See, e.g., Richard A. Brealey, Stewart C. Myers & Franklin Allen, Principles of Corporate Finance 8 (13th ed. 2020) ("The goal of maximizing shareholder value is widely accepted in both theory and practice.").

242. West, supra note 234, at 3, 14 (finding that in a survey of the "top 20 business and top 20 law schools as rated by media publications," students viewed "maximizing shareholder value" as the highest responsibility of a company).

243. See, e.g., Sanjai Bhagat & Roberta Romano, Event Studies and the Law, Part II: Empirical Studies of Corporate Law, 4 Am. L. & Econ. Rev. 380, 380 (2002) (explaining "the goal of corporate law is to increase shareholder wealth, and event studies provide a metric for measurement of the impact upon stock prices of policy decisions"); see also Robert Bartlett & Frank Partnoy, The Misuse of Tobin's *q*, 73 Vand. L. Rev. 353, 405 (2020) (discussing "the growing use and reliance on Simple *q* as a proxy for firm value" and how it has been used in "a large body of empirical scholarship" to "draw conclusions about what constitutes 'good' versus 'bad' corporate governance").

244. See, e.g., Rakesh Khurana, From Higher Aims to Hired Hands: The Social Transformation of American Business Schools and the Unfulfilled Promise of Management as a Profession 364 (2007) ("[B]usiness school professors instructed thousands of students

Professional education has served a potent avenue of social transmission: Studies show that when students enter business school, they tend to believe that the purpose of a corporation is to produce goods and services for the benefit of society, but by the time they graduate, they are more likely to believe its purpose is to maximize shareholder value.[245] These graduates in business and law go on to run and advise U.S. public corporations, from the top leadership position down to the newest hire. As such, the norms passed along in graduate education are enormously influential in corporate decisionmaking.[246]

2. *Media.* — The media has also played an important role in propelling the shareholder primacy view forward. To take a famous example, the *New York Times Magazine* selected for publication Friedman's 1970 essay, which is often credited with catalyzing the shareholder primacy movement.[247] In the decades that followed, hostile acquirers battled the press who labeled them "corporate raiders" who bled the economy.[248] Academics and other shareholder primacy proponents, however, countered these early reactions by advancing the agency costs view that takeovers disciplined wayward management and created shareholder value, with a beneficial effect on the economy.[249] This narrative seeped into mainstream coverage, which evolved to evaluate corporate actions in terms of whether they are value creating for shareholders.

As broader evidence of shareholder primacy's stronghold, consider how the media generally focuses on short-term stock market movements not just as evidence of management's capabilities but also of the health of the overall economy. To take a recent example, during the COVID-19 pandemic, news articles covered the peaks and troughs in the stock market as a sign of the country's economic outlook, despite signs of divergence.[250]

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and executives on how to use financial engineering tools, like leverage and stock options, to align corporate actions with the goal of maximizing shareholder value.").

245. McDonald, supra note 237, at 370.

246. West, supra note 234, at 3 ("If schools emphasize a particular set of values or approaches, it will reverberate for decades to come."). See generally Neil Fligstein & Doug McAdam, A Theory of Fields 79–80 (2012) (theorizing social change and identifying "higher education and professionals" as key influencers).

247. Aaron Brown, Opinion, Shareholder Primacy Means Shareholders Are Paid Last, Bloomberg (Sept. 5, 2019), https://www.bloomberg.com/opinion/articles/2019-09-05/shareholder-primacy-means-shareholders-are-paid-last (on file with the *Columbia Law Review*).

248. See, e.g., Leonard Silk, The Peril Behind the Takeover Boom, N.Y. Times, Dec. 29, 1985, at F1, https://www.nytimes.com/1985/12/29/business/the-peril-behind-the-takeover-boom.html (on file with the *Columbia Law Review*).

249. See, e.g., Michael C. Jensen, Takeovers: Folklore and Science, Harv. Bus. Rev., Nov. 1984, https://hbr.org/1984/11/takeovers-folklore-and-science [https://perma.cc/8HL8-DXAY].

250. See, e.g., Greg Rosalsky, What Is the Stock Market Trying to Tell Us?, NPR (June 16, 2020), https://www.npr.org/sections/money/2020/06/16/877410547/what-is-the-stock-market-trying-to-tell-us [https://perma.cc/YU8N-KDYQ] ("Economists consider the

The media's focus on share price and market performance is likely explained by the same intuitive simplicity that has resulted in shareholder primacy's lasting power elsewhere. As Lynn Stout explained, "[t]o the popular press and business media, shareholder primacy offered an easy-to-explain, sound-bite description of what corporations are and what they are supposed to do."[251] And, "[t]o businesspeople and reformers seeking a way to distinguish between good and bad governance practices, the shareholder-centric view promised a single, easily-read measure of corporate performance in the form of share price."[252]

In short, the language of shareholder primacy gave the business press an easily accessible frame to weigh in on company management via comparisons to a simple lodestar—shareholder value and, specifically, share price maximization.[253] That is not to say that all media coverage has favored shareholders, but that over time, the cultural acceptance of shareholder primacy as a desirable objective for the firm has bled into business reporting that appears neutral but, in reality, embeds many assumptions about the proper corporate objective.

3. *Politics.* — Finally, corporate governance reflects the political environment.[254] There are no universal principles of how politics align with issues of corporate governance, but scholars have identified some interesting patterns. In general, shareholder primacy has its roots in right-of-center thinking, whereas stakeholder models are embraced by politicians on the left side of the aisle.[255] Nonetheless, in the United States, both groups increasingly converged on shareholder primacy over the past two decades: As labor and pension funds used their growing governance power to advance their political interests,[256] left-of-center politicians embraced the expansion of shareholder rights.[257] This trend solidified after the

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stock market a 'leading indicator' of the economy, meaning it often signals where the real economy is headed.").

251. Stout, New Thinking, supra note 71, at 3.

252. Id.

253. Id.

254. See, e.g., Mark J. Roe, Political Determinants of Corporate Governance: Political Context, Corporate Impact 4 (2003) [hereinafter Roe, Political Determinants of Corporate Governance] (observing that the incidence of hostile takeovers, proxy fights, and incentive-based compensation are determined by "nation-by-nation specifics").

255. Stephen M. Bainbridge, Community and Statism: A Conservative Contractarian Critique of Progressive Corporate Law Scholarship, 82 Cornell L. Rev. 856, 857–58 (1997); Bruner, supra note 101, at 267. For a discussion of how state corporate law can engender partisan politics and how Delaware has used a perceived nonpartisan approach to its strategic advantage, see generally Ofer Eldar & Gabriel Rauterberg, Is Corporate Law Nonpartisan? (June 24, 2020) (on file with the *Columbia Law Review*) (unpublished manuscript).

256. Romano, Public Pension Fund Activism, supra note 149.

257. See William W. Bratton & Michael L. Wachter, Shareholders and Social Welfare, 36 Seattle U. L. Rev. 489, 513–14 (2013) (describing the "progressive overlay" of shareholder politics and the shared interests between labor and equity); Bruner, supra note 101, at 286 ("Since the turn of the millennium, shareholder-centric corporate governance

Enron accounting scandal and the financial crisis, which sparked criticism of ineffective monitoring mechanisms and a lack of managerial accountability to shareholder interests.[258] In the wake of these crises, liberal and conservative politicians united in passing corporate governance reform that strengthened shareholder power[259] and incorporated additional mechanisms to ensure that management prioritized shareholder interests.[260]

Another reason for this convergence is the shift from defined benefit to defined contribution retirement plans that rendered millions of working Americans forced investors in the stock market.[261] As the previous section discusses, this trend has increased the power and influence of institutional investors who manage these assets and wield the governance rights of American workers. It has also entrenched shareholder primacy across both sides of the political aisle: Elected officials understand that shareholder value creation affects not only the wealthiest one percent but also the millions of Americans who are investors through their pension funds and 401(k) accounts.[262] Moreover, the "rhetoric of shareholder value" is politically powerful when "the interests and perceptions of the investor class [are] viewed, however questionably, as largely coterminous with those of the citizenry at large."[263] This framing helps at times to forge alliances at the national level between financial and labor interests, supporting governmental responses ranging from enacting shareholder-focused corporate governance legislation to buttressing large corporations and securities markets.[264]

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reforms at the federal level have picked up pace, and such reforms have uniformly emerged from the political left.").

258. Mirela V. Hristova, Dodd-Frank's Corporate Governance Reform, 30 Rev. Banking & Fin. L. 516, 517 (2011).

259. Id. at 519–26 (detailing Dodd–Frank's attempts to promote increased accountability).

260. See Charles M. Elson & Christopher J. Gyves, The Enron Failure and Corporate Governance Reform, 38 Wake Forest L. Rev. 855, 883–84 (2003). For an argument that rising populist sentiment is unlikely to result in significant change in the law of corporate purpose, see Stephen M. Bainbridge, Corporate Purpose in a Populist Era, 98 Neb. L. Rev. 543, 577 (2019).

261. See Gilson & Gordon, supra note 83, at 881–82 (discussing how the rise of defined contribution plans increased the incidence of shareholding by ordinary Americans).

262. Bruner, supra note 101, at 267; Martin Gelter, The Pension System and the Rise of Shareholder Primacy, 43 Seton Hall L. Rev. 909, 911 (2013) (arguing that "changes in the pension system helped to transform corporate governance into a system dominated by the shareholder interest").

263. John W. Cioffi, Public Law and Private Power: Corporate Governance Reform in the Age of Finance Capitalism 110–16 (2010).

264. See Bruner, supra note 101, at 322–24 (describing the "coalition of financial and labor interests" that "allies shareholders and employees against management" and ties the framing to "interests and perceived vulnerabilities of the 'middle class'" to catalyze passage of legislation such as Sarbanes–Oxley and Dodd–Frank); David T. Zaring, The Government's Economic Response to the COVID-19 Crisis 4 (Aug. 7, 2020), https://ssrn.com/abstract=3662049 [https://perma.cc/2HKU-37RC] (unpublished

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From professional education and the media to politics, cultural elements work together to perpetuate shareholder primacy as the governing norm in the United States. The lack of global convergence toward a shareholder primacy model suggests that the orientation of the corporate governance machine should not be taken for granted—culture appears to be a driving force.

Of all the corporate governance machine's components, however, culture appears to be the most in flux. Academic institutions are increasingly coming under fire for teaching shareholder primacy at the exclusion of other viewpoints, and many are beginning to offer courses exploring sustainability, ESG, and stakeholder models.[265] Prominent scholars and professionals in business and law are likewise calling for change.[266] Norms have shifted quickly among S&P 500 companies toward voluntary reporting of social responsibility and sustainability efforts.[267] In turn, media outlets are increasingly observing that a shift away from shareholder primacy is taking place.[268] And finally, political parties, both

manuscript) (describing the Federal Reserve Board and Treasury Department responses to "sustain the U.S. economy amidst the pandemic"); Matt Phillips, Too Big to Fail: The Entire Private Sector, N.Y. Times (May 19, 2020), https://www.nytimes.com/2020/05/19/business/too-big-to-fail-wall-street-businesses.html (on file with the *Columbia Law Review*) ("In a bid to soften the coronavirus's economic blow, the government has stretched its financial safety net wide—from strategically sensitive companies, to entire industries such as energy and airlines, to the market for corporate bonds.").

265. Alternative management perspectives have also gained influence. See, e.g., Michael E. Porter & Mark R. Kramer, Creating Shared Value, Harv. Bus. Rev., Jan.–Feb. 2011, https://hbr.org/2011/01/the-big-idea-creating-shared-value [https://perma.cc/B222-PXHE].

266. See, e.g., Berger, supra note 152, at 662 ("There is now a growing recognition that the model of stockholder primacy is no longer acceptable, and that corporations must focus on broader corporate purposes, beyond stockholder value.").

267. See Flash Report: 86% of S&P 500 Index Companies Publish Sustainability/Responsibility Reports in 2018, Governance & Accountability Inst., Inc. (May 16, 2019), https://www.ga-institute.com/press-releases/article/flash-report-86-of-sp-500-indexR-companies-publish-sustainability-responsibility-reports-in-20.html [https://perma.cc/8ATQ-MY4J] ("During the year 2011, just under 20% of S&P 500 companies reported on their sustainability, corporate social responsibility . . . [while] for [the] year 2018, the total inched up to 86% of S&P 500 companies reporting.").

268. See, e.g., Steve Denning, Why Maximizing Shareholder Value Is Finally Dying, Forbes (Aug. 19, 2019), https://www.forbes.com/sites/stevedenning/2019/08/19/why-maximizing-shareholder-value-is-finally-dying [https://perma.cc/U63K-8HXY] (observing the media "hubbub" around the Business Roundtable's embrace of stakeholders); Moral Money, Fin. Times, https://www.ft.com/moral-money (on file with the *Columbia Law Review*) (biweekly newsletter on "the fast-expanding world of socially responsible business . . . [and] (ESG) trends") (last visited Aug. 10, 2021); Alan Murray & David Meyer, The End of Shareholder Primacy: CEO Daily, Fortune (Aug. 19, 2019), https://fortune.com/2019/08/19/the-end-of-shareholder-primacy-ceo-daily [https://perma.cc/59KZ-M85B] (arguing that the shareholder primacy model has been "scrapp[ed]").

from the right and left, have begun to attack shareholder primacy and offer proposals for change.[269]

It remains to be seen, however, whether cultural change can by itself manifest a shift away from shareholder primacy and whether other elements of the corporate governance machine will eventually catch on. And as Part IV discusses in greater detail, we suspect that the complementary institutional components that enshrine shareholderism will hamper a shift to a new paradigm if cultural forces alone are at play. Instead, we suspect that a shift in culture would need to drive concrete legal and institutional changes and alter multiple components of the machine if a paradigm shift were to manifest.

III. HOW THE CORPORATE GOVERNANCE MACHINE WORKS

The previous Part identifies the components of the corporate governance machine and hints at their reinforcing nature. This Part builds on this foundation and demonstrates how the corporate governance machine operates to force certain changes on companies and policymakers alike using three detailed examples. First, we explore how the corporate governance machine influenced the path of law and extralegal institutional standards to homogenize public company boards of directors consistent with a monitoring model. Second, we show that the corporate governance machine transformed the concept of corporate social responsibility into shareholder value–oriented ESG and, in so doing, propelled it to the mainstream. And third and finally, we demonstrate how the corporate governance machine forced alternative conceptions of corporate purpose into an entirely separate form of incorporation—the benefit corporation.

A. *Public Company Boards*

What is the function of the board of directors? At one point in time, corporate directors were envisioned as socially responsive trustees, helping management chart the right course of action for the company.[270] Indeed, in the 1950s—the "heyday of stakeholder capitalism and corporate managerialism"—corporate boards were composed of corporate insiders, with a sprinkling of outsiders with a variety of economic relationships with the company.[271] There was also a concerted effort *not* to align boards solely with shareholder interests as doing so "would undercut the desirable capacity of managers to manage in the public interest."[272]

In the 1970s, things changed. As Part I discusses, a series of corporate scandals brought to light how passively boards discharged their duties,

269. See, e.g., supra note 2 and accompanying text.

270. See, e.g., Jeffrey N. Gordon, The Rise of Independent Directors in the United States, 1950–2005: Of Shareholder Value and Stock Market Prices, 59 Stan. L. Rev. 1465, 1510–13 (2007) [hereinafter Gordon, The Rise of Independent Directors].

271. Id. at 1511, 1513.

272. Id. at 1514–15.

leading to a revisiting of the board's function.[273] Combined with early literature in law and economics, the board's role became to constrain managerial opportunism and minimize the agency problem created by the separation of ownership and control.[274]

This "monitoring" model took off. The American Law Institute (ALI) endorsed the monitoring function in its draft Principles of Corporate Governance, which suggested that at least a majority of the board should be independent directors.[275] This endorsement was not without controversy, however—the Principles project was drawn out and "resembled the rough-and-tumble politics of a state legislature."[276] But over time, the monitoring model won out, as legal and institutional players continued to push for board independence. For example, around the same time that the ALI finalized its Principles, the chairpersons of the SEC and the ABA Committee on Corporate Laws embraced the view that the chief function of the board is to monitor management for the benefit of shareholders.[277] The hostile takeover wave of the 1980s further solidified this development, as pursuit of shareholder value became the all-encompassing guide for corporate behavior.[278]

From then on, legal reform of the board of directors took a predictable tack. For example, the collapse of Enron and WorldCom led multiple players within the corporate governance machine to adopt more stringent independence requirements for directors. Although the root cause of these collapses were accounting failures, reformers blamed corporate boards for failing to stop managers from eroding gatekeeper integrity.[279] In response, the NYSE convened a corporate governance task force that generated strict director independence requirements as a precondition to being listed.[280] Shortly thereafter, Congress adopted the Sarbanes–Oxley Act of 2002, which requires the SEC to prohibit U.S. stock exchanges from listing securities unless the company had an audit committee composed solely of independent directors.[281]

273. See id.; see also supra notes 34–40 and accompanying text (describing the Penn Central bankruptcy and other corporate scandals).

274. Gordon, The Rise of Independent Directors, supra note 271, at 1518–20.

275. Stephen M. Bainbridge, The New Corporate Governance in Theory and Practice 160 (2008) [hereinafter Bainbridge, The New Corporate Governance].

276. Stephen M. Bainbridge, Independent Directors and the ALI Corporate Governance Project, 61 Geo. Wash. L. Rev. 1034, 1044 (1993).

277. See Corporate Rights and Responsibilities: Hearings Before the S. Comm. on Com., 94th Cong. 301–32 (1976) (statement of Roderick Hills, Chairman, SEC); ABA Comm. on Corp. L., Corporate Director's Guidebook, 33 Bus. Law. 1591, 1619–20 (1978) ("[T]he board of directors is . . . [the] reviewer of management initiatives and monitor of corporate performance . . . .").

278. Gordon, The Rise of Independent Directors, supra note 271, at 1527–28, 1540.

279. Id. at 1539.

280. Id.; NYSE Listed Company Manual § 303 (amended July 18, 2019).

281. Audit Committees and Auditor Independence, SEC, https://www.sec.gov/info/accountants/audit042707.htm [https://perma.cc/X9ZU-M9F6] (last updated May 7, 2007).

On top of this legal reform, proxy advisors ratcheted up pressure on corporate boards to increase board independence. For example, ISS's 2019 voting guidelines state: "Boards should be sufficiently independent from management . . . to ensure that they are able and motivated to effectively supervise management's performance for the benefit of all shareholders."[282] ISS enforces these policies by committing to recommend voting against insider directors when independent directors make up 50% or less of the board or an insider director serves on the audit, compensation, or nominating committees.[283]

These legal and extralegal changes led to a dramatic shift in board composition. From 1950 to the mid-2000s, the fraction of independent directors on large U.S. public company boards increased from approximately 20% to 75%.[284] That is so despite the fact that there is far from universal consensus that director independence leads to better board decisionmaking and oversight.[285] Yet the corporate governance machine pushed for this result. Specifically, after ideas incubated in academia led to an evolving cultural understanding of corporate governance, major institutional players—including the SEC, the stock exchanges, and influential proxy advisors—adopted rules that brought the monitoring model into the mainstream. By force of these developments, all U.S. public company corporate boards have a significant percentage of independent

282. ISS, United States Proxy Voting Guidelines Benchmark Policy Recommendations 8 (2019), https://www.issgovernance.com/file/policy/active/americas/US-Voting-Guidelines.pdf [https://perma.cc/423R-TFNS].

283. Id.

284. Gordon, The Rise of Independent Directors, supra note 271, at 1471.

285. See Stephen M. Bainbridge, A Critique of the NYSE's Director Independence Listing Standards 1–2 (UCLA Sch. of L., Rsch. Paper No. 02-15, 2002), https://ssrn.com/abstract=317121 [https://perma.cc/K29Z-KQE3] (describing the NYSE's proposals for increased director independence as "the warmed-over rejects of past corporate governance 'reform' initiatives"); see also Sanjai Bhagat & Bernard Black, The Uncertain Relationship Between Board Composition and Firm Performance, 54 Bus. Law. 921, 942 (1999) ("Most studies find little correlation [between board composition and firm performance], but a number of recent studies report evidence of a negative correlation between the proportion of independent directors and firm performance—the exact opposite of conventional wisdom."); Lisa M. Fairfax, The Uneasy Case for the Inside Director, 96 Iowa L. Rev. 127, 193 (2010) (arguing that "reliance on independent directors has been inappropriately used to substitute for rigorous external regulation"); Ronald J. Gilson & Jeffrey N. Gordon, Board 3.0: An Introduction, 74 Bus. Law. 351, 351–54 (2019) (arguing the dominant "monitoring board" of independent directors has "fallen short" and should be replaced with a new model of "thickly informed, well-resourced, and highly motivated directors").

directors[286] and view their role as safeguarding the interests of the corporation and its shareholders.[287]

B. *The ESG Movement*

Our next example begins in the Great Depression, when Professors Adolf Berle and Merrick Dodd famously debated corporate purpose. Berle's view was that managers should exercise power "only for the ratable benefit of all the shareholders,"[288] while Dodd argued that the corporation "has a social service as well as a profit-making function."[289] In the wake of that debate, Dodd appeared to be the victor.[290] During the mid-twentieth century period of managerial capitalism, corporate charitable giving became accepted practice and corporate managers acknowledged that businesses had social obligations.[291] In the 1950s, economist Howard Bowen coined the term "corporate social responsibility" out of a concern for corporate power and its impact on society.[292] His view was squarely aligned with Dodd's: He defined the social responsibilities of management as "the obligations of businessmen to pursue those policies, to make those decisions, or to follow those lines of action which are desirable in terms of the objectives and values of our society."[293]

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286. See Kobi Kastiel & Yaron Nili, The Corporate Governance Gap, 131 Yale L.J. (forthcoming 2021) (manuscript at 42), https://ssrn.com/abstract=3824857 [https://perma.cc/S33E-X7QW] (showing that all public company boards have a large percentage of independent directors).

287. See, e.g., Corp. L. Comm., ABA Bus. L. Section, Corporate Director's Guidebook—Seventh Edition, 75 Bus. Law. 2741, 2748 (2020) ("In determining the corporation's 'best interests,' directors should have in mind the interests of the shareholders as a whole."); OECD, G20/OECD Principles of Corporate Governance 45 (2015) https://www.oecd.org/corporate/principles-corporate-governance/ (on file with the *Columbia Law Review*) ("Board members should act on a fully informed basis, in good faith, with due diligence and care, and in the best interest of the company and the shareholders.").

288. A. A. Berle, Jr., Corporate Powers as Powers in Trust, 44 Harv. L. Rev. 1049, 1049 (1931).

289. E. Merrick Dodd, Jr., For Whom Are Corporate Managers Trustees?, 45 Harv. L. Rev. 1145, 1148 (1932).

290. See Adolf A. Berle, Jr., The 20th Century Capitalist Revolution 169 (1954) (acknowledging that the debate "ha[d] been settled (at least for the time being) squarely in favor of Professor Dodd's contention").

291. Howard R. Bowen, Social Responsibilities of the Businessman 125–27 (1953).

292. See id. at 6; see also Archie B. Carroll, A History of Corporate Social Responsibility: Concepts and Practices, *in* The Oxford Handbook of Corporate Social Responsibility 19, 25 (Andrew Crane, Dirk Matten, Abagail McWilliams, Jeremy Moon & Donald S. Siegel eds., 2008) ("[Howard] Bowen's publication of his landmark book *Social Responsibilities of the Businessman* (1953) best marks the beginnings of the modern period of literature on this subject.").

293. Elizabeth Pollman, Corporate Social Responsibility, ESG, and Compliance, *in* The Cambridge Handbook of Compliance 662, 663 (Benjamin van Rooij & D. Daniel Sokol eds., 2021) (quoting Howard E. Bowen, Social Responsibilities of the Businessman 6 (1953)); see also Ming-Dong Paul Lee, A Review of the Theories of Corporate Social Responsibility: Its Evolutionary Path and the Road Ahead, 10 Int'l J. Mgmt. Revs. 53, 56–58 (2008) (discussing Bowen's view of corporate social responsibility).

This view persisted in mainstream thinking for several decades. As in our previous example, however, much changed in the 1970s. Increasing adherence to the perspective famously espoused by Friedman—that a company's responsibility is to maximize shareholder profit—corresponded with a marginalization of corporate social responsibility and a new direction in research. This started with scholars in the 1980s who began to discuss corporate social responsibility as a decisionmaking process and explore how it could be operationalized through various frameworks, models, and evaluation methods.[294] And these models eventually began to rely on the link between corporate social responsibility and financial performance.[295]

By the early 2000s, researchers continued to explore the link between corporate social responsibility (CSR) and financial performance, accruing evidence of the "business case" for CSR. This led to a reframing—CSR was not bad for business, but good; therefore, the obligation to engage in CSR was part and parcel of management's duties to its shareholders. Around this time, CSR was largely recast as ESG and therefore inextricably linked with governance. The term ESG was coined by the United Nations following its 2005 conference "Who Cares Wins," which brought together institutional investors, financial analysts, consultants, and regulators.[296] The report that followed made the case that integrating ESG factors into corporate and investor decisionmaking was critical for the security of investments, prosperity, and growing markets.[297] Shortly after, in collaboration with an international group representing institutional investors, the United Nations launched at the New York Stock Exchange the "Principles for Responsible Investment," promoting the integration of ESG issues within the investment industry.[298]

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294. See, e.g., Mauricio Andrés Latapí Agudelo, Lára Jóhannsdóttir & Brynhildur Davídsdóttir, A Literature Review of the History and Evolution of Corporate Social Responsibility, 4 Int'l J. Corp. Soc. Resp. 1, 7 (2019) (citing Thomas M. Jones, Corporate Social Responsibility Revisited, Redefined, 22 Cal. Mgmt. Rev. 59, 60–62 (1980)) (noting that Jones was the "first author to consider CSR as a decision making process that influence[s] corporate behavior").

295. See, e.g., Philip L. Cochran & Robert A. Wood, Corporate Social Responsibility and Financial Performance, 27 Acad. Mgmt. J. 42, 43–48 (1984) (describing the use of a reputation index to explore the link between CSR and financial performance); Frank Tuzzolino & Barry R. Armandi, A Need-Hierarchy Framework for Assessing Corporate Social Responsibility, 6 Acad. Mgmt. Rev. 21, 22 (1981) (assessing CSR based on profitability).

296. See generally onValues Inv. Strategies & Rsch. Ltd., UN Glob. Compact, Investing for Long-Term Value: Integrating Environmental, Social and Governance Value Drivers in Asset Management and Financial Research (2005), https://www.scribd.com/fullscreen/16876744?access_key=key-mfg3d0usaiuaob4taki (on file with the *Columbia Law Review*) (detailing the conference goals, key outcomes, and insights).

297. Id. at iii.

298. About the PRI, Principles for Responsible Inv., https://www.unpri.org/about-the-pri [https://perma.cc/GLM6-P9EX] (last visited Aug. 10, 2021); see also Harper Ho, Enlightened Shareholder Value, supra note 13, at 81–82 (describing the PRI); Mariana Pargendler, The Rise of International Corporate Law (Eur. Corp. Governance Inst.,

Many players in the corporate governance system embraced this move and solidified it. First, the move to value-enhancing ESG was squarely consistent with the law in Delaware. Even scholars who advance a shareholder primacy view have agreed that boards of directors have significant discretion in nearly all circumstances to exercise their business judgment and that pursuing stakeholder interests can create value. Thus, value-enhancing ESG threaded the needle in terms of legal debates and was supported by the legal community. And although the move to value-enhancing ESG arguably narrowed the range of public-minded activities that companies might pursue, CSR advocates may have been willing to accept the ESG movement, as previous efforts to change corporate behavior had made limited inroads. In other words, in a world anchored to shareholder primacy, advocates of CSR may have realized that many lawmakers and legal advisors would only support reform that was framed as value-maximizing ESG.[299]

Second, market players ran with the concept. As investors started to accept the notion that integrating ESG measures could mitigate risk and create shareholder value,[300] various institutions realized they could supply metrics and other services for a fee. As a result, ratings agencies began providing ESG metrics, institutional investors offered ESG funds, and thousands of investment professionals billed themselves as "ESG analysts."[301] ESG became a business opportunity.

Law Working Paper No 555/2020), https://ssrn.com/abstract=3728650 [https://perma.cc/TL9Y-YAJX] (last updated Nov. 30, 2020) (describing the rise of ESG prompted by UN initiatives). Around this time, the United Nations also launched the Principles for Responsible Investment and the Sustainable Stock Exchanges Initiative. Who We Are, Sustainable Stock Exchs. Initiative, https://sseinitiative.org/about [https://perma.cc/JH7B-42NQ] (last visited Aug. 10, 2021).

299. See, e.g., Beate Sjåfell & Christopher M. Bruner, Corporations and Sustainability, *in* The Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability 3, 4 (Beate Sjåfell & Christopher M. Bruner eds., 2020) (distinguishing the "weak sustainability" view, which integrates ESG into the "mainstream" focus on long-term financial performance, from "strong sustainability" which "simply means actual sustainability").

300. See Gadinis & Miazad, supra note 16, at 1410 (claiming that "[s]ocial risks arise when a company makes a business choice that exemplifies, epitomizes, or overlooks challenges rattling large societal groups, whole areas of economic activity, or even society as a whole"); Virginia Harper Ho, Risk-Related Activism: The Business Case for Monitoring Nonfinancial Risk, 41 J. Corp. L. 647, 684–85 (2016) (proposing that "[m]ore widespread integration of ESG measures into standard investment analysis would address several important structural objections to risk-related activism").

301. See Joseph A. Hall & Betty M. Huber, Davis Polk & Wardwell LLP, ESG in the US: Current State of Play and Key Considerations for Issuers, *in* The International Comparative Legal Guide to: Corporate Governance 23, 23–30 (12th ed. 2019), https://www.davispolk.com/sites/default/files/esg_in_the_us_-_current_state_of_play_and_key_considerations_for_issuers_0.pdf [https://perma.cc/SF9X-FDN6] (summarizing ESG raters and methodologies); Dana Brakman Reiser & Anne Tucker, Buyer Beware: Variation and Opacity in ESG and ESG Index Funds, 41 Cardozo L. Rev. 1921, 1930–35 (2020) (describing ESG investment options); Georg Kell, The

Third and finally, these changes may be sparking further cultural shift. As a sign of the general acceptance of value-enhancing ESG, consider that during the 2019 proxy season, more than half of the shareholder proposals brought involved ESG issues, including topics such as disclosing climate change risk and increasing board diversity.[302] These proposals are not only being brought more regularly, they are also more likely to result in favorable results for shareholder proponents and, specifically, voluntary withdrawal in favor of negotiated settlements and greater overall support for those proposals that go to a shareholder vote.[303] In other words, the evolution of CSR into value-enhancing ESG has propelled it into the mainstream, as legal and market players no longer hinder but instead amplify these efforts. This example reveals how the corporate governance machine took a concept that was unlinked from shareholders, and through law, institutions, and culture, reshaped it, and in so doing, allowed it to thrive.

C. *Benefit Corporations*

To the extent a business wants to pursue profits and a social purpose that is inconsistent with shareholder wealth maximization, it now has a customized option: organize as a benefit corporation. This new form of business organization is a twenty-first century reflection of how the corporate governance machine has transformed CSR into an entirely different form of corporation. Moreover, even the benefit corporation is subject to the forces of shareholder power, further demonstrating the stickiness of the machine's shareholderist orientation.

The benefit corporation concept has been decades in the making as partial legal measures along the way fell short.[304] During the 1980s wave of hostile takeovers, many states adopted constituency statutes designed to insulate a corporation's board of directors from breach of fiduciary duty

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Remarkable Rise of ESG, Forbes (July 11, 2018), https://www.forbes.com/sites/georgkell/2018/07/11/the-remarkable-rise-of-esg/?sh=69fd0e7d1695 [https://perma.cc/PU8S-6QDZ] (noting that ESG is "now, quite literally, big business" with "multi-billion dollar economic consequences").

302. See Gary Larkin, On Governance: 2019 Proxy Season Was Huge for E&S Proposals, Conf. Board (Sept. 9, 2019), https://conference-board.org/blog/environmental-social-governance/ES-Proposals-Proxy-Season [https://perma.cc/3HR6-YSNX]; Hannah Orowitz & Brigid Rosati, An Early Look at the 2020 Proxy Season, Harv. L. Sch. F. on Corp. Governance (June 10, 2020), https://corpgov.law.harvard.edu/2020/06/10/an-early-look-at-the-2020-proxy-season [https://perma.cc/6ED9-SNT8].

303. See Orowitz & Rosati, supra note 303; John D. Stoll, This Proxy Season, It's Revenge of the Nurdles, Wall St. J. (Apr. 12, 2019), https://www.wsj.com/articles/this-proxy-season-its-revenge-of-the-nurdles-11555074005 (on file with the *Columbia Law Review*).

304. See Larry Hamermesh, Bart Houlahan, Rick Alexander & Dan Osusky, A Conversation With B Lab, 40 Seattle U. L. Rev. 321, 329 (2017).

suits for considering the impact of their decisions on stakeholders.[305] Practically speaking, however, the existence of constituency statutes has not made much difference in the governance of most traditional corporations. States such as Delaware and California, home to the majority of public corporations and venture-backed startups, never adopted such statutes. And, most significantly, constituency statutes are merely permissive and do not commit corporate boards to pursuing stakeholder interests.[306]

Against this background, corporate reformers decided to push for an alternative. Around the same time that CSR was transformed into value-maximizing ESG, a nonprofit corporation called B Lab pushed state legislatures across the country to add a new form of business organization to their corporate codes. B Lab emerged out of the social enterprise movement and, specifically, through the grassroots efforts of former business partners who came to believe that shareholder primacy was fundamentally flawed.[307]

Their first initiative was to offer businesses the opportunity to apply for certification as a "B Corp," a standard they invented to denote that a company had scored highly on their self-created metrics for "good business" practices related to governance, workers, community, environment, and customers.[308] Subsequently, B Lab created model legislation for a new form of corporation designed to pursue profits as well as a social mission.[309] Key features of the benefit corporation model legislation include a social purpose expressly stated in the charter, fiduciary duties requiring directors to consider the effect of decisions on stakeholders, and regular reporting obligations on social purpose activity.[310] In many other respects, however, the benefit corporation model adopts features of the traditional corporation. For example, shareholders have the power to elect the board of directors and the right to sue to enforce fiduciary obligations; therefore, a benefit corporation's protection from the corporate governance machine is only as strong as the long-term commitment of its shareholders

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305. See Brett H. McDonnell, Corporate Constituency Statutes and Employee Governance, 30 Wm. Mitchell L. Rev. 1228, 1231 (2004).

306. See Stephen M. Bainbridge, Interpreting Nonshareholder Constituency Statutes, 19 Pepp. L. Rev. 971, 987 n.86 (1992) (noting that "the legislatures saw the statutes as making only minor changes in the law"). Some influential commentators advocated interpreting constituency statutes to allow consideration of stakeholders only to the extent consistent with existing law, which they stated as requiring shareholder primacy. ABA Comm. on Corp. L., Other Constituencies Statutes: Potential for Confusion, 45 Bus. Law. 2253, 2269 (1990).

307. Hamermesh et al., supra note 305, at 326.

308. Id.; see also Michael B. Dorff, Assessing the Assessment: B Lab's Effort to Measure Companies' Benevolence, 40 Seattle U. L. Rev. 515, 523–26 (2017).

309. Model Benefit Corporation Legislation, B Lab (Apr. 17, 2017), https://benefitcorp.net/sites/default/files/Model%20benefit%20corp%20legislation%20_4_17_17.pdf [https://perma.cc/C2F2-TVT3].

310. Brett H. McDonnell, Benefit Corporations and Public Markets: First Experiments and Next Steps, 40 Seattle U. L. Rev. 717, 720 (2017).

to the stakeholder approach.[311] Notably, these social entrepreneurs did not attempt to change corporate governance from within the traditional corporate form—they understood from previous business experiences and corporate law advisors that shareholder primacy was deeply ingrained, and they believed the path for change therefore lay outside of the existing structure.

In 2010, B Lab succeeded in persuading their first state, Maryland, to adopt benefit corporation legislation and expanded from there.[312] Naturally, as they continued their campaign, the B Lab team had their sights focused on Delaware.[313] When B Lab pitched its legislation to the council of the Delaware Bar Association that recommends changes to the corporate code, the response was predictably skeptical. As one lawyer explained, "[O]ur initial reaction was that just sounds like this other constituency statute thing that we rejected many years ago because we know how corporate law works."[314] When further pressed to consider such legislation, the council's task force came around to the view that even if not necessarily "the best model," allowing for private ordering was within the spirit of Delaware's approach.[315] That is, the benefit corporation could be one choice among a menu of organizational options, with the traditional corporation remaining focused on shareholders and undisturbed in its prominence.

This understanding helped catapult adoption of the benefit corporation legislation to over thirty states, including Delaware, which adopted its own, less stringent version.[316] As a matter of culture and politics, the idea of the benefit corporation gained rare bipartisan support as state legisla-

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311. A small number of benefit corporations have gone public and in doing so some have employed additional protections from outside shareholder interference, including antitakeover provisions and dual-class stock, that are generally disfavored by the corporate governance machine. See Ann Lipton, Benefit Corporations Go Public, Bus. L. Prof Blog (July 18, 2020), https://lawprofessors.typepad.com/business_law/2020/07/benefit-corporations-go-public.html [https://perma.cc/6FWP-W3YR].

312. See B Lab, Maryland First State in Union to Pass Benefit Corporation Legislation, CSRwire (Apr. 14, 2010), https://www.csrwire.com/press_releases/29332-Maryland-First-State-in-Union-to-Pass-Benefit-Corporation-Legislation [https://perma.cc/65BL-C6LA]. Benefit corporation legislation has been enacted in over thirty states. B Corporation Tracker, Soc. Enter. L. Tracker, https://socentlawtracker.org/#/bcorps [https://perma.cc/Q3D2-492E] (last updated Mar. 6, 2020).

313. Hamermesh et al., supra note 305, at 327.

314. Id.

315. Id. at 328.

316. See Frederick Alexander, Benefit Corporation Law and Governance: Pursuing Profit With Purpose 87 (2018) (noting Delaware's public benefit corporation statute is "less rigid" and gives "the choice to veer from . . . shareholder primacy, without giving up the key elements of conventional governance" such as business judgment rule protection and "without imposing regulatory-like disclosure burdens"); Alicia E. Plerhoples, Delaware Public Benefit Corporations 90 Days Out: Who's Opting In?, 14 U.C. Davis Bus. L.J. 247, 250 (2014) (noting Delaware's public benefit corporation statute is "less restrictive" than B Lab's model legislation).

tors from different ends of the political spectrum supported either business as a force for social good or the freedom of entrepreneurs to engage in private ordering of their business affairs.[317] Not only that, market players easily embraced a model that was aligned with shareholder value creation.[318] Ultimately, however, the success of the benefit corporation as a separate business form reinforces the corporate governance machine's directional focus on shareholder interests for the vast majority of companies.[319]

IV. Implications and Future Paths

The previous Parts provide a novel descriptive account of the system of corporate governance that has reigned in the United States over the past half century. We now turn to examining the broad implications of our analysis for multiple pressing debates in corporate law. First, we explore how the corporate governance machine shapes the development of corporate regulation in a predictable shareholderist direction. Beyond corporate purpose, we consider how the machine affects corporate governance in other important ways, including by dampening incentives to innovate and pushing public companies toward homogeneous governance structures. The latter observation also informs our conclusion that the existence of the corporate governance machine may be affecting incentives for private companies to go public and, in so doing, affects the activities performed by public companies. We also reflect on what the existence of the corporate governance machine reveals about the future of corporate governance and, in particular, the outlook for proponents of a stakeholder governance system.

A. *Shaping the Development of Corporate Regulation*

In the United States, for over a half century, corporate reform has generally moved in one direction—toward advancing shareholder interests. Although there are counterexamples, the larger war has been won;

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317. Hamermesh et al., supra note 305, at 328.

318. Id. at 358 (describing how major proxy advisory firms and institutional investors were on board with the creation of B Lab to the extent it would "create [shareholder] value").

319. To date, approximately 3,000 benefit corporations have been formed in the United States, representing 0.05% of U.S. businesses. U.S. Census Bureau, 2019 Annual Business Survey–Company Summary (2019), https://data.census.gov/cedsci/table?tid=ABSCS2018.AB1800CSA04&hidePreview=true&nkd=EMPSZFI~001,ETH_GROUP~001,RACE_GROUP~00,SEX~001,VET_GROUP~001 (on file with the *Columbia Law Review*) (estimating approximately 5.7 million employer firms in the United States); B Corps and Benefit Corporations, Urb. Sustainability Dirs. Network, https://sustainableconsumption.usdn.org/initiatives-list/b-corps-and-benefit-corporations [https://perma.cc/FBE3-6CAT] (last visited Aug. 10, 2021) (reporting 3,000 U.S. benefit corporations).

indeed, even the rules restricting shareholder rights and powers are justified as benefitting them in aggregate. Our analysis provides an explanation for this arc: The corporate governance machine forcefully dictates that shareholders are the proper ends of corporate decisionmaking.

We can observe the influence of the machine in contemporary advocacy for corporate governance reform. Consider, for example, the issue of ESG disclosures. Two prominent academics, Jill Fisch and Cynthia Williams, have urged the SEC to require ESG disclosures for public companies.[320] Rather than stating the request broadly in terms of disclosure that would benefit the public, Fisch and Williams contend instead that ESG disclosures reveal information that would be material to the *investing* public. This tendency to frame reform, and specifically corporate disclosures, to meet shareholder needs strikes some as overly narrow.[321] Yet, as the above discussion reveals, it is a wise strategic move in our existing system that prioritizes investor interests. The SEC, for instance, has faced increasing calls for mandating climate-related disclosures. For a long period, it maintained its status quo approach, emphasizing the materiality standard as the core disclosure focus. Eventually, the SEC slightly opened the door to change by welcoming "market participants" to assist it in "better understanding how issuers and investors use environmental and climate-related information to make capital allocation decisions."[322]

A similar pattern emerges in practice and soft law norms. For example, as voluntary ESG disclosure standards emerge and gain adherents, we see the flexible, shareholder-oriented SASB standards winning out in the United States, despite the fact that tougher, more stakeholder-oriented GRI standards are popular elsewhere and have existed longer.[323] In turn,

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320. Cynthia A. Williams & Jill E. Fisch, Petition to SEC for Rulemaking on Environmental, Social, and Governance (ESG) Disclosure, Harv. L. Sch. F. on Corp. Governance (Oct. 9, 2018), https://corpgov.law.harvard.edu/2018/10/09/petition-to-sec-for-rulemaking-on-environmental-social-and-governance-esg-disclosure [https://perma.cc/AC7R-8EQ5]; see also Virginia Harper Ho, Nonfinancial Risk Disclosure and The Costs of Private Ordering, 55 Am. Bus. L.J. 407, 413 (2018) (arguing that mandatory ESG disclosure would serve the SEC's mission of protecting investors, facilitating capital formation, and promoting fair, orderly, and efficient markets).

321. See Lipton, Mandatory Stakeholder Disclosure, supra note 117, at 501–03.

322. Jay Clayton, Chairman, SEC, Statement on Proposed Amendments to Modernize and Enhance Financial Disclosures; Other Ongoing Disclosure Modernization Initiatives; Impact of the Coronavirus; Environmental and Climate-Related Disclosure (Jan. 30, 2020), https://www.sec.gov/news/public-statement/clayton-mda-2020-01-30 [https://perma.cc/2RWX-KV39]. The current SEC Chair Gary Gensler has asked the SEC staff to "develop a mandatory climate risk disclosure rule proposal" by the end of 2021, emphasizing that many investors want this information. See Gary Gensler, Chair, SEC, Prepared Remarks Before the Principles for Responsible Investment "Climate and Global Financial Markets" Webinar (July 28, 2021), https://www.sec.gov/news/speech/gensler-pri-2021-07-28 [https://perma.cc/6YMP-GHK6].

323. See Attracta Mooney & Billy Nauman, Larry Fink Rules on the Best Global Standards for Climate Risk Reporting, Fin. Times (Jan. 20, 2020), https://www.ft.com/content/fc51227b-9d64-4e5a-b1e2-f6c07f4caa58 (on file with the *Columbia Law Review*). The Sustainability Accounting Standards Board (SASB) and the

proxy advisors and ratings agencies have evolved to supply ESG metrics for corporations and investors.[324] These examples show that the machine is slowly moving in the direction of incorporating stakeholder interests, on the grounds that this is what investors want.[325] This suggests that reform couched in these terms has a real chance of success.

Despite the widening lens, however, this advocacy ultimately reinforces the corporate governance machine's shareholderist orientation.[326] For one, the fact that legal reformers work within the language and conceptual framing of shareholder primacy solidifies the cultural understanding that corporations exist for the benefit of their shareholders. Second, to the extent that legal reforms strengthen shareholder power, this further locks in the corporate governance machine's orientation. Consider, for example, Dodd–Frank's say-on-pay mandate.[327] This rule gave shareholders a nonbinding vote on executive compensation and in so doing also amplified the role of proxy advisors who supply voting advice to meet investor interests and consult corporations in structuring pay-for-performance compensation.[328] Therefore, in addition to making management subject to shareholder voice in this area, the rule further sustains players who perpetuate the dynamics of the corporate governance machine.

B. *Pushing One-Size-Fits-All Governance*

The operation of the corporate governance machine may have negative consequences for shareholders, as well as stakeholders. Despite the

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Global Reporting Initiative (GRI) are organizations with the mission of developing sustainability reporting standards. Id.

324. Hall & Huber, supra note 302, at 23.

325. Global trends toward investor stewardship and ESG disclosure requirements might also encourage U.S. investors to integrate ESG measures. See Renaud Breyer & Laurent Capolaghi, Key Impacts of the New ESG Disclosure Rules for the Fund Ecosystem, EY (Jan. 16, 2020), https://www.ey.com/en_lu/wealth-asset-management/luxembourg-market-pulse/esg--stewardship--key-impacts-of-the-new-esg-disclosure-rules- [https://perma.cc/3FXJ-E85F] (discussing ESG transparency requirements on European fund managers); see also UK Stewardship Code 2020, Fin. Reporting Council, https://www.frc.org.uk/getattachment/5aae591d-d9d3-4cf4-814a-d14e156a1d87/Stewardship-Code_Dec-19-Final-Corrected.pdf [https://perma.cc/9Z3V-JNN6] (last visited Aug. 26, 2021) (establishing twelve stewardship principles for U.K. asset managers and asset owners).

326. To the extent that shareholder value diverges from social welfare, the regulatory trend presents troubling consequences. See Berger, supra note 152, at 666–67 (arguing that "a stockholder primacy ideology means that corporate purpose generally will be decided by what is in the interests of the top 10 percent income bracket in this country"); Bratton, The Separation of Corporate Law and Social Welfare, supra note 44, at 788 ("[S]hareholder value does not proxy for social welfare and no progress in that direction has registered during the shareholder value era.").

327. Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 951, 124 Stat. 1376, 1899–900 (codified as amended at 15 U.S.C. § 78n–1 (2018)).

328. Randall S. Thomas, Alan R. Palmiter & James F. Cotter, Dodd-Frank's Say on Pay: Will It Lead to a Greater Role for Shareholders in Corporate Governance?, 97 Cornell L. Rev. 1213, 1231–32 (2012).

lack of consensus about universal good governance practices, the corporate governance machine pushes many firms toward one-size-fits-all governance solutions. These solutions are often embodied in corporate governance codes adopted by industry groups, as well as the voting guidelines adopted by proxy advisors and major institutional investors.

According to these codes and guidelines, company governance should be modeled after a set of best practices. These best practices emphasize board independence, equal shareholder voting rights, executive compensation linked to performance, and governance structures that enhance responsiveness to shareholders. And companies that do not fall in line with these principles suffer consequences. For example, ISS recommends a no-vote for any company that has a staggered board.[329] Influential institutional investors further enforce these precepts through their voting practices.[330] As a result, the governance structure of most large U.S. public companies looks nearly the same: annual director elections, majority voting, proxy access, no poison pill, and independent board leadership.[331]

The difficulty, of course, is that there is little evidence that maximum accountability to shareholders is the right choice for every company—even from the perspective of shareholder wealth maximization.[332] Indeed, there is evidence that one-size governance solutions can destroy value.[333]

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329. James Cheap, Board Classification and Diversity in Recent IPOs, Harv. L. Sch. F. on Corp. Governance (Apr. 24, 2018), https://corpgov.law.harvard.edu/2018/04/24/board-classification-and-diversity-in-recent-ipos/ [https://perma.cc/PWJ5-B8DZ] (citing ISS Proxy Voting Guidelines, supra note 283, at 18).

330. Colin J. Diamond & Michelle Rutta, BlackRock Publishes Updated Proxy Voting Guidelines, White & Case (Feb. 21, 2018), https://www.whitecase.com/publications/alert/blackrock-publishes-updated-proxy-voting-guidelines [https://perma.cc/K2VP-22SJ] ("BlackRock, like a growing number of other large institutional investors, intends to wield its proxy voting power to influence corporate governance and management practices.").

331. This effect is most pronounced for the largest U.S. companies. See Kosmas Papadopoulos, Robert Kalb, Angelica Valderrama & Jared Sorhaindo, ISS, U.S. Board Study: Board Accountability Practices Review 2 (2008), https://www.issgovernance.com/file/publications/board-accountability-practices-review-2018.pdf [https://perma.cc/Y7FD-VKMK] ("Governance practices between S&P 500 and the rest of the members of the S&P 1500 continue to differ significantly. More importantly, the rate of governance change between the two groups varies in many areas, as large-caps tend to adopt shareholder-friendly board accountability practices more quickly compared to smaller firms.").

332. See, e.g., Zohar Goshen & Doron Levit, Irrelevance of Governance Structure 2–3 (Eur. Corp. Governance Inst., Fin. Working Paper No. 606/2019, 2020), https://ssrn.com/abstract=3340912 [https://perma.cc/9E2T-REUX] ("Almost every aspect of corporate governance that was studied in the last forty years yielded conflicting empirical findings, for instance: dual-class shares; anti-takeover defenses, such as poison pills, staggered boards, and protective state legislations; and the strength of corporate governance as measured by several indices." (citation omitted)).

333. For example, there is evidence that mandatory board independence requirements can harm firm value when applied to different companies. See Jeffrey L. Coles, Naveen D. Daniel & Lalitha Naveen, Boards: Does One Size Fit All?, 87 J. Fin. Econ. 329, 351 (2008); Onur Kemal Tosun, Changes in Corporate Governance: Externally Dictated vs Organically Determined 28 (WBS Fin. Grp., Rsch. Paper No. 246, 2018), https://ssrn.com/abstract=3105695 [https://perma.cc/H5WE-PFTR]. Likewise, the stock market negatively

Consider a technology company that is pursuing "moonshot" innovation that has never been done before and might require long periods of gestation. That company might benefit from greater insulation from investor pressure—a staggered board and perhaps even a dual-class structure—in order to pursue its vision and secure the best long-term results.[334] Or consider a mature biotechnology company with complex products and highly technical operations. That company faces substantial tradeoffs when it brings an independent director on board; on the one hand, that director may be less beholden to management, on the other, she may be less likely to have industry-specific expertise or knowledge of the company's operations. Indeed, the optimal board of directors for this company from the perspective of shareholders might feature very few, if any, independent directors. The corporate governance machine, however, will push the company toward adding a majority of independent directors, undermining the company's optimal governance. Furthermore, other dynamics, including the preferences or agency costs of intermediated investment, may be at work when investors push for one-size-fits-all governance practices.[335]

Ultimately, this issue deserves additional study; here, we observe that, to the extent that the operation of the corporate governance machine dictates a uniform governance blueprint for vastly different firms, it may erode corporate value. Paradoxically, it also undermines the unfettered

reacts to companies that change their executive compensation practices before a shareholder vote because of proxy advisor recommendations—indicating that such proxy advisor recommendations (which tend to follow a one-size-fits-all rubric) do not create shareholder value. See Larcker et al., Outsourcing Shareholder Voting, supra note 185, at 173–204. Further, a study found that companies that separate the chairperson and CEO roles in response to shareholder pressure likewise experience a lower valuation and reduced operating performance. See Aiyesha Dey, Ellen Engel & Xiaohui Liu, CEO and Board Chair Roles: To Split or Not to Split?, 17 J. Corp. Fin. 1595, 1613 (2011). Finally, researchers in the United Kingdom have determined that companies that depart from default corporate governance code provisions tend to perform better than those that comply with preset defaults. Sridhar R. Arcot & Valentina G. Bruno, One Size Does Not Fit All, After All: Evidence From Corporate Governance 18–20 (2007), https://ssrn.com/abstract=887947 [https://perma.cc/6UMD-K3N6] (unpublished manuscript).

334. See Zohar Goshen & Assaf Hamdani, Corporate Control and Idiosyncratic Vision, 125 Yale L.J. 560, 579–83 (2016).

335. One might ask, for example, if one-size-fits-all governance solutions destroy firm value, why do institutional investors and their advocates support them? Diversified investors may have incentives to support blanket practices that they expect will improve the value of the portfolio as a whole. See generally Gordon, Systematic Stewardship, supra note 15 (describing how diversified investors should seek to minimize systematic risk to maximize risk-adjusted returns). Or, these policies may be the product of agency costs if such institutional investors lack the time and incentive to develop firm-specific rules that would benefit investors. See Lund, Against Passive Shareholder Voting, supra note 178, at 516 ("[T]he engagement teams do not use an active voting strategy and instead promulgate voting guidelines and follow them closely.").

bargaining model that underpins shareholder primacy.[336] A key premise in the law and economics defense of shareholder primacy is that a corporation is a nexus of contracts and that parties can freely contract for rules that are welfare-maximizing.[337] But the path dependence that arises from dogmatically equating certain shareholderist practices with good governance, and the influence of market players that profit from establishing and maintaining this playbook, may restrict the range of options that firms adopt. Over time, this dynamic may limit the enabling nature of corporate law that many scholars champion as welfare maximizing.

C. *Hampering Corporate Governance Innovation*

The corporate governance machine's emphasis on a platonic governance ideal leads to an additional and closely related result: It hampers innovation in corporate governance. In other words, the corporate governance machine not only pushes corporations to adopt the same governance blueprint, it also restricts the items that appear on the menu.

Corporate governance innovation has become relatively rare.[338] Indeed, apart from the benefit corporation, one of the last major innovations—the poison pill—was a brainchild of the 1980s designed to respond to the increased risk of a hostile takeover.[339] As the rest of this section explains, the accompanying crackdown on its use was itself a product of the nascent corporate governance machine. And it provides an example of the lifecycle of innovations in corporate governance that do not fit cleanly within the shareholder primacy framework.

The first poison pill was used in the early 1980s, at the advent of the hostile takeover wave.[340] Its rise in popularity kicked off a legal battle as to whether its use was a proper exercise of board discretion. To convince the Delaware Supreme Court of its propriety, the pro-management lawyers who developed the pill went to great lengths to suggest that its use would

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336. See Bainbridge, The New Corporate Governance, supra note 276, at 33 (discussing how the shareholder wealth maximization norm is a "bargained-for contract term" in the contractarian model and rests "on the presumption of validity a free market society accords voluntary contracts").

337. See Easterbrook & Fischel, supra note 12, at 12, 67–70 ("[W]e often speak of the corporation as a 'nexus of contracts' or a set of implicit and explicit contracts. This reference, too, is shorthand for the complex arrangements of many sorts that those who associate voluntarily in the corporation will work out among themselves.").

338. Robert B. Thompson, Why New Corporate Law Arises: Implications for the Twenty-First Century, *in* The Corporate Contract in Changing Times: Is the Law Keeping Up? 3, 3 (Steven Davidoff Solomon & Randall Stuart Thomas eds., 2019) (providing an overview of the key developments in corporate law over the nineteenth century and remarking that corporate governance has remained stable since then).

339. Chase deKay Wilson, Marty Lipton's Poison Pill, Int'l Fin. L. Rev., May 1984, at 10, 10–11.

340. Id.; see also William B. Chandler III, The Delaware Court of Chancery: An Insider's View of Change and Continuity, 2012 Colum. Bus. L. Rev. 411, 413–14 (discussing the history of the poison pill).

benefit shareholders, dubbing it a "shareholder rights plan," and arguing that its use was necessary to secure a fair offer for the company's shares.[341] The Delaware Supreme Court validated the pill, and companies continued to adopt them.[342] The popularity of the pill, however, sparked a wave of pushback. Many academics, lawyers, proxy advisors, and investors decried the use of a tool that they deemed entrenching.[343] That was so despite the fact that the empirical evidence about whether the poison pill benefitted shareholders was mixed.[344] After being labeled a tool of "bad governance," poison pills have mostly fallen out of use at public companies as a matter of standing governance.[345] Even Wachtell Lipton Rosen & Katz, the law firm credited with the pill's invention, noted in response to the COVID-19 pandemic and the corresponding resurgence in pills that "the negative view of rights plans by the proxy advisory services and some institutional investors" makes it generally inadvisable for companies to adopt a poison pill without a specific threat.[346]

For another example of the issues that accompany governance innovation, consider the blowback against the use of dual-class stock. For the past hundred years, dual-class stock has been used to respond to different business concerns. For example, in the 1920s, bankers used differential voting rights as a way of keeping control over the companies they took public. Their argument was that the use of differential voting rights helped control agency costs and signal managerial quality in an era with few disclosure requirements and weak investor protections.[347] Dual-class stock has since been used as a takeover defense, to keep control within families in

341. See Answering Brief of Defendants Below-Appellees at 60, Moran v. Household Int'l, Inc., 500 A.2d 1346 (Del. 1985) (Nos. 37 & 47), https://www.law.upenn.edu/live/files/7383-a [https://perma.cc/VY59-ZL87].

342. See *Moran*, 500 A.2d at 1357 (validating the poison pill); Gerald F. Davis, Agents Without Principles? The Spread of the Poison Pill Through the Intercorporate Network, 36 Admin. Sci. Q. 583, 585 (1991) (noting that by 1989, 60% of the Fortune 500 had poison pills).

343. See, e.g., Emiliano M. Catan, The Insignificance of Clear-Day Poison Pills, 48 J. Legal Stud. 1, 2–3 (2019) (describing the demise of the preemptive poison pill); Ronald J. Gilson, *Unocal* Fifteen Years Later (and What We Can Do About It), 26 Del. J. Corp. L. 491, 506 (2001); D.L. Sunder, The Controversial 'Poison Pill' Takeover Defense: How Valid are the Arguments in Support of It?, 23 NMIMS Mgmt. Rev. 47, 49–50 (2013).

344. See, e.g., John C. Coates IV, Takeover Defenses in the Shadow of the Pill: A Critique of the Scientific Evidence, 79 Tex. L. Rev. 271, 336–39 (2000).

345. They typically exist only as a "shadow" option. Id.

346. David Katz & Sabastian V. Niles, Rights Plans ("Poison Pills") in the COVID-19 Environment—"On the Shelf and Ready to Go"?, Harv. L. Sch. F. on Corp. Governance (Apr. 2, 2020), https://corpgov.law.harvard.edu/2020/04/02/rights-plans-poison-pills-in-the-COVID-19-environment-on-the-shelf-and-ready-to-go [https://perma.cc/9LNX-USN7].

347. See Jeffrey N. Gordon, Dual Class Common Stock: An Issue of Public and Private Law, CLS Blue Sky Blog (Jan. 2, 2019), https://clsbluesky.law.columbia.edu/2019/01/02/dual-class-common-stock-an-issue-of-public-and-private-law [https://perma.cc/48GP-7BZY]; see also John C. Coffee, Jr., Dual Class Stock: The Shades of Sunset, CLS Blue Sky Blog (Nov. 19, 2018), https://clsbluesky.law.columbia.edu/2018/11/19/dual-class-stock-the-shades-of-sunset [https://perma.cc/6HZQ-Y88K].

family-owned companies, to protect the journalistic integrity of media companies, and most recently, to keep control in the hands of visionary technology company founders taking their companies public.[348] And despite these varied uses, the form of criticism that has followed each iteration has been the same—that dual-class structures are antidemocratic and lead to entrenchment and thus should be discouraged or even prohibited.[349]

The pushback against the most recent wave of dual-class IPOs by technology companies provides an example of this dynamic in action. As companies began offering low-voting and nonvoting stock to public shareholders—again, with the stated goal of promoting corporate value and benefitting shareholders in the long term—the corporate governance machine began to work. In particular, proxy advisors, investor advocacy groups, and prominent investors saw the use of dual-class stock as an entrenching governance practice and began speaking out against it.[350] These groups lobbied stock exchanges, stock indices, and the SEC, seeking regulation limiting a company's ability to issue differential shares. The media also painted dual-class structures and nonvoting shares in a negative light.[351] Despite protestations by scholars and companies that differential voting rights would sometimes benefit shareholders, three major stock index providers, including MSCI, FTSE Russell, and S&P Dow Jones, proposed to exclude prospective dual-class companies from their indices.[352]

Although agency theory adherents might celebrate this result as a win for promoting shareholder democracy and minimizing managerial agency costs, a less rosy view is that the corporate governance machine constrains value-enhancing experimentation in governance when that innovation

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348. See supra notes 210–212 and accompanying discussion.

349. See Lund, Nonvoting Shares, supra note 210, at 692–93.

350. See, e.g., ISS, The Tragedy of the Dual Class Commons 3 (Feb. 13, 2012), http://online.wsj.com/public/resources/documents/facebook0214.pdf [https://perma.cc/FQ4E-PLPE]; Dawn Lim, BlackRock, Calpers Want Exchanges to Clamp Down Dual-Class Shares, Wall St. J. (Oct. 24, 2018), https://www.wsj.com/articles/blackrock-and-calpers-to-stock-exchanges-clamp-down-on-dual-class-shares-1540394503 (on file with the *Columbia Law Review*); Ross Kerber & Jessica Toonkel, T. Rowe Price to Oppose Key Directors at Super-Voting Share Companies, Reuters (Mar. 7, 2016), https://www.reuters.com/article/us-troweprice-directors/exclusive-t-rowe-price-to-oppose-key-directors-at-super-voting-share-companies-idUSKCN0W90F2 [https://perma.cc/6AY3-RKWN].

351. See, e.g., Kathleen Pender, Lyft Wants the Public's Money, but Not Their Input, S.F. Chron. (Mar. 20, 2019), https://www.sfchronicle.com/business/networth/article/Lyft-wants-the-public-s-money-but-not-their-13701367.php (on file with the *Columbia Law Review*); Kara Swisher, Opinion, You Can't Fire Mark Zuckerberg's Kid's Kids, N.Y. Times (Nov. 27, 2019), https://www.nytimes.com/2019/11/27/opinion/tech-dual-class-stock.html (on file with the *Columbia Law Review*) ("Welcome to the world of perpetual dual-class stock, an old finance trick that has been used — and now abused — with great enthusiasm by the tech giants.").

352. Pender, supra note 352. MSCI has since changed course. Id.

threatens shareholder rights.[353] And as before, this orientation undermines the enabling nature of corporate law that is often described as its most desirable feature.[354]

D. *Influencing the Public/Private Divide*

A greater diversity of governance arrangements emerges in the private company context, yet this observation also tells us something about the corporate governance machine. Private companies regularly depart from the corporate governance machine's precepts: Many private companies have unequal voting rights, founder-dominated boards, and other "bad governance" characteristics.[355] These governance arrangements have been accepted as tolerable, or even necessary, to protect small, innovative companies with visionary founders or companies that wish to stay true to social missions.[356]

This all changes once a company goes public: Newly minted public companies are subject to heightened scrutiny from institutional investors, ratings agencies, investor advocacy groups, stock exchanges, stock indices, and proxy advisors. As a result, most private companies are forced to shed the governance practices that shaped their early growth as soon as they access the public markets.[357] They must conform their boards to public

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353. An optimal governance structure might, for example, take into account principal costs as well as agency costs. See Zohar Goshen & Richard Squire, Principal Costs: A New Theory for Corporate Law and Governance, 117 Colum. L. Rev. 767, 796–98 (2017).

354. See, e.g., Roberta Romano, The Genius of American Corporate Law 1 (1993) (arguing that "[t]he genius of American corporate law is in its federalist organization" in which "[f]irms choose their state of incorporation" and state corporate codes provide terms "that function as default provisions in corporate charters that firms can tailor more precisely to their needs").

355. See Renee M. Jones, The Unicorn Governance Trap, 166 U. Pa. L. Rev. Online 165, 167, 179–82 (2017) (arguing unicorn companies present "governance problems"); Josh Lerner & Ramana Nanda, Venture Capital's Role in Financing Innovation: What We Know and How Much We Still Need to Learn 12–13 (Nat'l Bureau of Econ. Rsch., Working Paper No. 27492, 2020), https://www.nber.org/papers/w27492 [https://perma.cc/HR28-7L8C] (arguing "founder-friendly" structures reflect "declining governance" of startups). See generally Elizabeth Pollman, Startup Governance, 168 U. Pa. L. Rev. 155 (2019) [hereinafter Pollman, Startup Governance] (describing venture capital contracting and the governance of venture-backed startups).

356. See Yvon Chouinard, Let My People Go Surfing: Education of a Reluctant Businessman 155 (2005) ("Being a publicly held corporation . . . would put shackles on how we operate, restrict what we do with our profits, and put us on a growth/suicide track. Our intent is to remain a closely held private company, so we can continue to focus on our bottom line: doing good."); Goshen & Hamdani, supra note 335, at 577–79 (discussing idiosyncratic vision); Pollman, Startup Governance, supra note 356, at 181–83, 205 (discussing the dynamics in which startup founders bargain for dual-class structures or other protections).

357. Pollman, Startup Governance, supra note 356, at 209–10 ("Going public offers a chance to unwind a complicated and largely contractual governance structure in favor of a more traditional allocation of rights and responsibilities."); see also Scott Kupor, Secrets of Sand Hill Road: Venture Capital and How to Get It 160–61 (2019) (discussing how preferred stock converts to common stock at IPO).

company rules and norms regarding size and composition, such as those favoring director independence.[358] They must also deal with the reality that they will be subject to the demands of a host of new shareholders that are well positioned to use their governance rights to ensure alignment with shareholder interests.[359] Companies like Google and Facebook that maintain private-style governance in their voting structures are in the minority, and even these companies face intense public scrutiny and pressures to conform their practices.[360]

The insight that the corporate governance machine contributes to this result is an important missing piece of the discussion about why companies are choosing to stay private longer. Previous scholarship has focused on the availability of private capital, burdensome regulation and disclosure requirements, the increased prospect of agency costs that comes from a dispersed shareholder base, and increased litigation.[361] The corporate governance machine serves as another powerful deterrent for companies that might otherwise access public markets sooner in their life cycle—and one that is even more difficult to grapple with.[362] Startups with visionary leaders and market leverage have pushed for dual- or multiclass structures to insulate themselves from the corporate governance machine—and in so doing have been one of the few sources of governance variation injected into public markets.

The corporate governance machine may also affect the balance of whether certain activities are performed by large public companies rather than smaller private ones. For example, there is evidence that emphasis on shareholder value and accountability to shareholders renders public companies less likely to invest in research and development relative to

358. See, e.g., David F. Larcker & Brian Tayan, Stanford Closer Look Series, Scaling Up: The Implementation of Corporate Governance in Pre-IPO Companies 1 (2018), https://www.gsb.stanford.edu/sites/default/files/publication-pdf/cgri-closer-look-2018-scaling-up-the-implementation-of-corporate-governance-in-pre-ipo-companies_0.pdf [https://perma.cc/87WF-VLPQ] (discussing IPO "readiness" through the evolution of corporate governance practices in private companies).

359. See Claudine Gartenberg & George Serafeim, 181 Top CEOs Have Realized Companies Need a Purpose Beyond Profit, Harv. Bus. Rev. (Aug. 20, 2019), https://hbr.org/2019/08/181-top-ceos-have-realized-companies-need-a-purpose-beyond-profit (on file with the *Columbia Law Review*) (finding "lower levels of purpose (other than shareholder wealth maximization) in publicly listed companies, relative to private firms").

360. See, e.g., Mark Bergen, Tech Shareholder Activists Take Yearly Swing With Renewed Hope, Bloomberg (June 2, 2021), https://www.bloomberg.com/news/newsletters/2021-06-02/tech-shareholder-activists-take-yearly-swing-with-renewed-hope (on file with the *Columbia Law Review*).

361. See Elisabeth de Fontenay, The Deregulation of Private Capital and the Decline of the Public Company, 68 Hastings L.J. 445, 462 (2017) (discussing the literature on the costs of public company status).

362. See Pollman, Startup Governance, supra note 356, at 215 (discussing "the governance costs and liquidity pressure that develop in the extreme late stage of startups").

private companies.[363] Investments in research and development do not always pan out, and shareholders may prefer that excess cash be returned to them rather than spent on speculative projects. Public companies might embrace this cost-saving strategy despite the potential for investments in research and development to fuel growth and innovation that produce long-term social benefits and strengthen sustainability in competitive global market economies. In any case, the corporate governance machine's influence should be viewed as not only contributing to the trend of companies staying private longer and pushing for dual-class structures but also shaping the activity of those in the public realm.

E. *The Future of Corporate Governance*

We have thus far examined a range of implications that arise from a shareholderist-oriented corporate governance machine. In this final part of our discussion, we reflect on the future direction of the U.S. system of corporate governance.

A central implication is that advocates of CSR or stakeholderism that wish to see a move away from shareholder primacy will be frustrated by the corporate governance machine. The diversity of corporate governance systems around the world and the failure of the convergence hypothesis to materialize demonstrate that a shareholder-dominated system is not inevitable.[364] Yet it has proven sticky in the United States and, as it has permeated law, institutions, and culture, it has generated a reinforcing momentum.[365] Although our account does not answer whether shareholder primacy is optimal, it opens the door to the view that the corporate governance infrastructure that exists is the product of path dependence, rather than efficient evolution. The fact that many

363. See John Asker, Joan Farre-Mensa & Alexander Ljungqvist, Corporate Investment and Stock Market Listing: A Puzzle?, 28 Rev. Fin. Stud. 342, 358 (2015) (finding that public firms invest less than a matched sample of private firms); Josh Lerner, Morten Sorensen & Per Strömberg, Private Equity and Long-Run Investment: The Case of Innovation, 66 J. Fin. 445, 474–75 (2011) (documenting that firms that have gone private through leveraged buyouts register patents that are more cited and more concentrated in important areas for their portfolios).

364. For a sampling of the literature examining corporate governance divergence, see Gelter, Taming or Protecting the Modern Corporation, supra note 84, at 676–78; Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, Corporate Ownership Around the World, 54 J. Fin. 471, 491 (1999); Roe, Political Determinants of Corporate Governance, supra note 255, at 1–3.

365. Japan presents an interesting parallel, where the law initially embraced a stakeholder model and eventually shifted to shareholder primacy, but cultural and institutional forces have preserved the focus on stakeholders. See, e.g., Kana Inagaki, Spotlight Thrown on Japan Inc.'s Stakeholder-Focused Model, Fin. Times (Oct. 8, 2019), https://www.ft.com/content/34faf1aa-e991-11e9-a240-3b065ef5fc55 (on file with the *Columbia Law Review*). For another example of how institutions can reinforce a stakeholder model, consider Germany and its codetermination model, which is protected and enhanced by several complementary institutions. See Jens Dammann & Horst Eidenmüller, Codetermination: A Poor Fit for U.S. Corporations, 2020 Colum. Bus. L. Rev. 870, 878–86.

institutional players profit from the orientation of the machine and thus serve as gatekeepers reinforces this view. And importantly, the institutional framework substantially increases the cost of switching to a new paradigm.[366]

To understand why incremental change is unlikely to manifest a major shift to stakeholderism, consider the following hypothetical scenario: Imagine that the Delaware Supreme Court stated in a judicial opinion that corporate fiduciaries could choose to sacrifice shareholder returns (over the long and short term) to benefit employees or the public at large.[367] Such a statement would end the doctrinal debate over corporate purpose that has consumed much scholarly attention for the past few decades. But with what effect? Will Amazon award a large share of profits to its warehouse workers? Will American Airlines stop producing carbon emissions?

Additional legal discretion will not likely catalyze these changes. And the corporate governance machine is largely to blame. In particular, management will likely predict that routine profit-sacrificing that is not widely supported by investors and consumers is unlikely to increase the company's stock price,[368] and therefore, these actions could lead to a cascade of negative consequences for the management team. Most directly, the decision to put other groups ahead of shareholders could sacrifice management's own compensation, which has become increasingly tied to the company's financial performance as a result of pressure from the machine's institutional players. Perhaps even more importantly, the decision could attract negative attention from investors, especially if governance ratings agencies downgraded the company in the wake of the move.[369] Other shareholders might instead use their governance rights to show disapproval such as by voting against executive pay at the next annual meeting. Proxy advisors, too, would likely react unfavorably, directing their shareholder clients to vote against management. Investor advocacy

366. See Roe, Chaos and Evolution, supra note 11, at 644–46. Not only that, changing one part of a complementary system in an effort to improve it can cause the system to perform worse, not better, because the pieces no longer function as fluidly. Paul Milgrom & John Roberts, Complementarities and Systems: Understanding Japanese Economic Organization, 9 Estudios Económicos 3, 12 (1994); see also Ronald J. Gilson & Curtis J. Milhaupt, Economically Benevolent Dictators: Lessons for Developing Democracies, 59 Am. J. Comp. L. 227, 239–40 (2011). This reality adds an additional barrier to change, as well as additional reasons to be skeptical about the optimality of the system.

367. In some respects, this hypothetical is not far from existing doctrine as many scholars would already characterize corporate law as director-centric in terms of the balance of managerial power and discretion afforded to boards of directors. See Bainbridge, Director Primacy, supra note 3, at 550; Blair & Stout, supra note 90, at 251.

368. Prosocial corporate activity that is widely supported by investors and consumers is unlikely to have a negative effect on the company's stock price and might even increase it. See, e.g., Dorothy S. Lund, Corporate Finance for Social Good, 121 Colum. L. Rev. 1617, 1641 n.105 (2021) (discussing the example of Dick's Sporting Goods and its decision to stop selling guns, which ended up boosting revenue).

369. See supra section II.B.7.

groups would similarly protest any move that downgraded shareholder value. And if the company continued to make significant prosocial profit-sacrificing choices into the future, it is likely that influential investors with concentrated investments in the company would do more, or activists would take positions to do so. For example, those investors could wage a proxy fight until management changed course or was replaced with individuals who were better aligned with shareholder interests.[370]

Put simply, legal discretion is not enough to broadly change corporate behavior if the other components of the corporate governance machine remain intact. Although investors are increasingly choosing ESG investment vehicles, and some are even engaging in ESG activism, there remains a link between the prosocial action that investors demand and value maximization.[371] By contrast, to regularly sacrifice profits to benefit the public, a company's management would need insulation from shareholders, but this insulation is anathema to the corporate governance machine and is not the norm.[372] Although shareholder primacy has come under pressure in our cultural understanding of how companies should operate, at the end of the day, "good governance" continues to be defined by its link to accountability to shareholders.[373] It is not clear that the growing cultural acceptance of an enlightened approach toward stakeholders will put out the shareholder primacy fire that fuels the corporate governance machine, although it may substantially impact its evolution.

The key point is that as the shareholder primacy viewpoint has become enmeshed in our cultural and institutional understanding of good governance and as multiple powerful players operate as gatekeepers for the shareholder primacy norm, it becomes difficult to move to another

370. See Hart & Zingales, supra note 17, at 260.

371. For example, the successful proxy fight that ESG investor Engine No. 1 waged at Exxon Mobil was couched in terms of long-term performance. See Justin Baer & Dawn Lim, The Hedge-Fund Manager Who Did Battle With Exxon—and Won, Wall St. J., https://www.wsj.com/articles/the-hedge-fund-manager-who-did-battle-with-exxonand-won-11623470420?mod=hp_lead_pos10 (on file with the *Columbia Law Review*) (last updated June 12, 2021) (quoting Engine No. 1's manager that "the stock should go up" if its proposed strategy for the company is "right"); Stephen Bainbridge, The ExxonMobil Proxy Fight Was Not a Triumph for Woke Capitalism, ProfessorBainbridge.com (June 14, 2021), https://www.professorbainbridge.com/professorbainbridgecom/2021/06/the-exxonmobil-proxy-fight-was-not-a-triumph-for-woke-capitalism.html [https://perma.cc/a2c8-phdb] ("Engine No.1's arguments were focused on ExxonMobil's subpar financial performance, emphasizing that over the preceding ten years ExxonMobil had lost money while stock market indices had tripled.").

372. See supra notes 73–83 and accompanying text; see also Mark J. Roe, Corporate Purpose and Corporate Competition (Eur. Corp. Governance Inst., Law Working Paper No. 601/2021, 2021), https://ssrn.com/abstract=3817788 [https://perma.cc/H8DX-9DPP] ("[I]n competitive markets, the profit-oriented but purpose-pressured firm has no choice but to refuse the purpose pressure (or to give it only lip service), while in monopolistically-organized industries, the purpose-pressured firm has more room to maneuver.").

373. See supra notes 79–83, 216–220 and accompanying text; see also Kastiel & Nili, supra note 287 (describing good governance in these terms).

paradigm—one that gives power to other stakeholders or allows corporate executives to make decisions based on the corporate entity, overall social value, or something else.[374] This observation raises questions about the optimality of the system—it could be that path dependence leads us to the efficient result, but that result is not guaranteed.[375] More important, without a substantial shock to the system, such as a federal chartering requirement directing companies to adopt a stakeholder governance model that would cause a shift across multiple institutions at once,[376] stakeholderism is unlikely to dethrone shareholder primacy as the dominant decisionmaking framework.

Instead, the corporate governance machine will push stakeholder advocates to fit their models into the existing infrastructure. This development has already begun to take place. For example, stakeholder advocates emphasize that consideration of stakeholder welfare is necessary for corporate profit maximization over the long term. As shifts in understanding occur regarding the merits of various ESG initiatives and better metrics develop for measuring these benefits, a greater level of stakeholder interests can be reconciled with pursuing long-term shareholder value. Not only that, some observers have urged corporations to consider shareholder value more holistically, recognizing that shareholders are individuals with diverse preferences. And because these "enlightened" shareholder primacy perspectives incorporate stakeholder interests into shareholderism, they are likely to make it through the corporate governance machine and spread widely.

But although an enlightened shareholder value approach allows for greater consideration of stakeholder welfare, it ultimately serves only a partial victory to advocates of stakeholderism. In particular, tying the consideration of stakeholder welfare to long-term shareholder value limits acceptable rationales and favors activity that can be reduced to measurable metrics tied to risk or financial value. It also renders the promotion of stakeholder welfare that cannot be justified as benefitting shareholders as outside the bounds of acceptable corporate activity, no matter the overall welfare benefits.

The acceptance of an enlightened shareholder value approach also means that the corporation's social conscience may be externally determined. Take sexual harassment as an example. The success of the #metoo

374. See supra note 366.

375. See Roe, Chaos and Evolution, supra note 11, at 646–52 (explaining that the "original path does not have to be very strong for it to explain how we got to where we are").

376. See, e.g., Accountable Capitalism Act, S. 3348, 115th Cong. (2018) (sponsored by Sen. Elizabeth Warren). This proposed legislation could throw sand in the gears of the machine by mandating sweeping corporate governance changes including requiring employee representatives to serve on the board, requiring federal charters for large corporations, and giving directors the duty to create a general public benefit. Id. As a result, legal and private institutional gatekeepers would be forced to change in line with these new legal requirements.

movement has created a business case for sexual harassment prevention,[377] but before 2017, such socially desirable corporate activity was often neglected. Without this external pressure, there was no impetus for change, regardless of the social benefits. Simply put, tying a company's obligation to engage in socially beneficial conduct to value maximization means that important issues may slip through the cracks.

Not only that, the corporate governance machine will likely affect the future path of corporate ESG. As discussed, surviving the corporate governance machine requires the embrace of its institutional players. ESG can create business opportunities for many of them, particularly proxy advisors, stock exchanges, and ratings agencies. As such, these market players are likely to embrace ESG activities that can be easily measured and scored, for investor and perhaps even public consumption. This in turn will shape the types of ESG activities that companies choose to engage in. And over time, as market players continue to develop metrics and products for companies at scale, corporate ESG activities are likely to coalesce around standard practices or take a one-size-fits-all form, too.

As one example of this progression, consider board diversity. In the past few years, a number of market participants have made gender diversity a priority.[378] For example, in 2017, the influential investor State Street promised to vote against nominating directors of companies that lacked any female directors.[379] BlackRock subsequently announced that it expected its portfolio companies to each have at least two female directors.[380] In response to these and other efforts, hundreds of companies added one or two female directors to their boards.[381] Despite gender

377. See Daniel Hemel & Dorothy S. Lund, Sexual Harassment and Corporate Law, 118 Colum. L. Rev. 1583, 1612 (2018) (discussing the ways in which sexual harassment can impair corporate profitability).

378. See Sullivan & Cromwell LLP, 2018 Proxy Season Review 23 (2018), https://www.sullcrom.com/files/upload/SC-Publication-2018-Proxy-Season-Review.pdf [https://perma.cc/G33G-BLHW] (describing efforts to increase gender diversity on boards made by a proxy advisor, institutional investors, and advocacy groups).

379. Joann S. Lublin & Sarah Krouse, State Street to Start Voting Against Companies That Don't Have Women Directors, Wall St. J. (Mar. 7, 2017), https://www.wsj.com/articles/state-street-says-it-will-start-voting-against-companies-that-dont-have-women-directors-1488862863?mod=article_inline (on file with the *Columbia Law Review*).

380. Sarah Krouse, BlackRock: Companies Should Have At Least Two Female Directors, Wall St. J. (Feb. 2, 2018), https://www.wsj.com/articles/blackrock-companies-should-have-at-least-two-female-directors-1517598407 (on file with the *Columbia Law Review*).

381. Amy Whyte, State Street to Turn Up the Heat on All-Male Boards, Inst. Inv. (Sept. 27, 2018), https://www.institutionalinvestor.com/article/b1b4fh28ys3mr9/State-Street-to-Turn-Up-the-Heat-on-All-Male-Boards [https://perma.cc/6NED-VC5P]; see also John Pavlus, Companies Are Adding More Women to Their Boards. What's Driving the Change?, KelloggInsight (May 3, 2021), https://insight.kellogg.northwestern.edu/article/women-company-boards [https://perma.cc/TG48-HMEP] (discussing research finding that "the Big Three" were drivers of increase in board diversity and "[t]he way a company changed their board corresponds to who holds large ownership stakes in them, and what those specific asset managers were pushing for").

diversity increasing on corporate boards, women remain underrepresented on boards and in other key leadership positions such as CEO.[382] Further, market players did not initially focus on other aspects of diversity, and those aspects remained neglected.[383] More recently, market players and lawmakers have begun to turn their attention to efforts aimed at increasing racial and ethnic diversity on corporate boards.[384] In particular, the SEC has approved a Nasdaq requirement seeking to encourage listed companies to advance the diversity of directors who self-identify as an underrepresented minority or LGBTQ+.[385] Although there are many reasons to applaud these efforts, the constraints of an enlightened shareholder value approach may increase the possibility that companies will comply in a minimal or check-the-box fashion without taking a critical look at whether their boards and the rest of their workforce are truly diverse and inclusive.[386]

In sum, the legacy of the corporate governance machine is not just the continued constraint of corporate activity in the service of shareholder welfare, but also the co-optation of stakeholderism. The desirability of this reality is subject to much debate, but as our analysis indicates, wholesale

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382. See Andie Kramer, Where Are All The Women Directors?, Forbes (Mar. 20, 2020), https://www.forbes.com/sites/andiekramer/2020/03/20/where-are-all-the-women-directors/?sh=4ea41c229b89 (on file with the *Columbia Law Review*) (noting that only 20% of directors of Russell 3000 companies are women and 20% of companies in the Russell 3000 have no women directors); see also Women Bus. Collaborative, C200 & Catalyst, Women CEOs in America: Changing the Face of Business Leadership 8 (2020), https://womenceoreport.org/the-report/ (on file with the *Columbia Law Review*) (finding that 5.2% of Russell 3000 CEOs are women, an "all-time high" of 7.8% of Fortune 500 CEOs are women, and less than 1% are women of color).

383. See Chris Brummer & Leo E. Strine, Jr., Duty and Diversity, 75 Vand. L. Rev. 1 (forthcoming 2022) (manuscript at 10), https://ssrn.com/abstract=3788159 [https://perma.cc/C4XF-BADL] (noting that "focus on the composition of boards [in recent decades] has not translated into boards representative of our nation"); Lisa M. Fairfax, Racial Reckoning With Economic Inequities: Board Diversity as Symptom and Partial Cure, 106 Cornell L. Rev. Online (forthcoming 2021) (manuscript at 14) (on file with the *Columbia Law Review*) ("The lack of board diversity is a visible symptom of a significant problem that corporate America has failed to solve.").

384. See Sullivan & Cromwell LLP, 2020 Proxy Season Review: Part 1—Rule 14a-8 Shareholder Proposals 27–29, (2020), https://www.sullcrom.com/files/upload/SC-Publication-2020-Proxy-Season-Review-Part-1-Rule-14a-8.pdf [https://perma.cc/R64F-R3SU] (describing activity related to racial and ethnic diversity on boards through initiatives by institutional investors, the SEC, Congress, and the California state legislature).

385. Rules Related to Board Diversity, Exchange Act Release No. 34-92590, 86 Fed. Reg. 44,424, 44,424–25 (Aug. 6, 2021).

386. See Brummer & Strine, supra note 384, at 18, 38 (observing that the "gap in representation . . . jumps at every step across the corporate hierarchy" and "diversity can only be operationalized as an organizational feature if it is accompanied by an equitable and inclusive culture"); Lisa M. Fairfax, Board Diversity Revisited: New Rationale, Same Old Story, 89 N.C. L. Rev. 855, 859 (2011) (arguing that "the business case, standing alone, is insufficient to ensure enhanced diversity in the boardroom" and highlighting "the important role that social and moral justifications must continue to play in such efforts").

change away from this model is unlikely to manifest in the foreseeable future absent a substantial shock to the system.

CONCLUSION

Understanding the complex and reinforcing nature of the U.S. corporate governance system is essential for understanding corporate decisionmaking and how to reform it. Our descriptive account of the corporate governance machine has wide-ranging implications for multiple conversations in corporate law, and the debate over corporate purpose in particular. Indeed, as the cultural conversation has turned to increasingly vocal calls for reorientation of purpose away from shareholder primacy, our analysis sheds light on the complexity of this project. As shareholder primacy has evolved from a rule to a system, it has generated a reinforcing momentum. In particular, the institutional framework that encompasses the corporate governance machine substantially increases the costs associated with moving to a new paradigm. As such, stakeholderism is unlikely to dethrone shareholder primacy; however, it may gain ground by shaping the meaning of shareholder primacy to encompass stakeholder interests. Indeed, this may well be the legacy of the corporate governance machine over the long-term: Even when the traditional shareholder primacy viewpoint no longer wins the day, the apparatus that it generated will continue to influence the path of corporate conduct and legal reform for years to come.