Anti-Primacy: Sharing Power in American Corporations

By Robert B. Thompson*

Prominent theories of corporate governance frequently adopt primacy as an organizing theme. Shareholder primacy is the oldest and most used of this genre. Director primacy has grown dramatically, presenting in at least two distinct versions. A variety of alternatives have followed—primacy for CEOs, employees, creditors. All of these theories cannot be right. This article asserts that none of them are. The alternative developed here is one of shared power among the three actors named in corporations statutes with judges tasked to keep all players in the game. The debunking part of the article demonstrates how the suggested parties lack legal or economic characteristics necessary for primacy. The prescriptive part of the article suggests that we can better understand the multiple uses of primacy if we recognize that law is not prescribing first principles for governance of firms, but rather providing a structure that works given the economic and business environment in place for modern corporations where separation of function and efficiencies of managers provide the starting point. Thus, the familiar statutory language putting all power in the board must be read against the reality of the discontinuous nature of the board (and shareholder) involvement in governance. Corporate governance documents of the largest American corporations, as discussed in the article, are consistent with this reality, assigning management to officers and using verbs like oversee, review, and counsel as the director functions. The last part examines dispute resolution and the role of judges in such a world, with a particular focus on the shareholder/director boundary. At this boundary there are two distinct judicial roles, the traditional role focusing on use of fiduciary duty to check conflict and other director incapacity and the less-recognized role of protecting shareholder self-help. In this more modern context shareholders, because of market and economic developments, are able to effectively participate in governance in a way that was not practical three decades ago, when the key Delaware legal doctrines were taking root. What is particularly interesting here is how courts, commentators, and institutional investors act in a way that is consistent with a shared approach to power, as opposed to the primacy of any of the theories initially suggested.

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I. INTRODUCTION

Contemporary debates about the ends and means of corporate law have cen-
tered on concepts of primacy of one sort or another. The term is most often as-
signed to shareholders\(^1\) or directors\(^2\) in a seeming duel for corporate power, but
the principal protagonist is really management, usually assumed to have de facto
power in modern American corporations.\(^3\) In turn, these labels have provoked a
series of additional proposals suggesting primacy of other players, for example,
employees\(^4\) or creditors.\(^5\)

The multiplicity of recipients to which primacy has been attached ought to
suggest the limits of the explanatory power of any primacy theory.\(^6\) The use of
primacy theories to describe both ends and means makes it difficult to maintain
any consistent theoretical approach. This article points instead to power sharing
among the three sets of actors named in all American corporations statutes—
shareholders, directors, and officers—each intentionally endowed to check the
powers of the others and courts inserted as continuing facilitators of this manda-
tory power sharing. This balance of power as to the means of exercising corporate
power also is visible in the “ends” part of the debate. Corporate law’s purpose is
to provide a structure for private ordering within which a broad group of partic-
ipants can contract for exchange and have available a governance structure to fill
gaps. The shared power of shareholders, directors, and managers, each checking
the other, facilitates maximizing value of exchange in these relationships.

Part II examines the arguments set out in primacy’s two most developed man-
ifestations in corporate law and why neither is true. Shareholders play a crucial,
but decidedly subordinate, role in corporate governance. Despite recurring ref-
ences to shareholder primacy and to shareholders as owners of the corpora-
tion, their power is not the plenary power of a primate or an owner, but rather
limited to doing only three things—voting, selling, and suing—and each in very
limited doses.\(^7\)

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1. See, e.g., Henry Hansmann & Reinier Kraakman, The End of History for Corporate Law, 83 GEO.
L.J. 439, 440–41 (2001). A Westlaw search for “shareholder w/2 primacy” (as of July 30, 2014) pro-
duced 1201 hits in the Journals and Law Reviews database, the earliest in the late 1980s, although as
Part II.A describes the core ideas go back considerably further; a similar search for “director w/2 pri-
macy” produced about half that many hits—586—and “manage! w/2 primacy” returned 90 hits.

2. See, e.g., Stephen M. Bainbridge, Director Primacy: The Means and Ends of Corporate Governance,
97 NW. U. L. REV. 547 (2003); Margaret M. Blair & Lynn A. Stout, A Team Production Theory of Cor-

3. See, e.g., George W. Dent, Jr., Academics in Wonderland: The Team Production and Director Pri-
mary Models of Corporate Governance, 44 HOU S. L. REV. 1213, 1215 (2008) (“[T]he status quo is
not director primacy, shareholder primacy or team production, but CEO primacy, governance by
managers largely for their own benefit. The interests not only of shareholders but other constituencies
and the public would fare better with shareholder primacy.”); William W. Bratton, Hedge Funds and
Governance Targets, 95 GEO. L.J. 1375, 1476 (2007) (describing twentieth-century managerialist ap-
proach that puts corporate management at the large corporation’s strategic center).

4. See Brett H. McDonnell, Employee Primacy, or Economics Meets Civic Republicanism at Work, 13

5. See Frederick Tung, The New Death of Contract: Creeping Corporate Fiduciary Duties for Creditors,

887, 947 (2000) (suggesting a model in which “there is no primacy, no core, no hierarchy, no prom-
inent participant, no firm, no fiduciary duty”).

7. See Robert B. Thompson, Preemption and Federalism in Corporate Governance: Protecting Share-
The strength of directors’ powers is such that they are sometimes described in primacy terms. Yet the board is also a strange choice for a primacy role. Directors have little skin in the game and often have full-time work elsewhere. Their incentive structure, measured by compensation, share ownership, and other sources, is much more low-powered than that for managers, and their access to information is only a fraction of that available to officers. They are simply not in a position to manage a complex enterprise. The other primary theories get less attention here, but fare no better.

Part III presents the shared power alternative. The idea reflects some of the same motivations of the political choices found in our Constitution—limits on the power of government and reliance on a balance of power in making those limits effective. But public corporations are different. In particular: (a) the separation of function with the specialization of efforts that follows if the modern corporation is going to deliver on its efficiency potential; and (b) the standard agency story from economics (and politics) as to risks that flow from that specialization when some actors end up with “power over vast aggregations of property that they do not own.”

The practical reality in large public corporations is that managers make most corporate decisions, a direct result of the triumph of specialization and the efficiencies that come from it. Centralized managers in a hierarchy provide efficiencies in information gathering, decision making, and implementation that dispersed and numerous shareholders (or employees or creditors) simply cannot match. The statutory roles for directors and shareholders are structured in the shadow of that economic reality and only make sense from a starting point that presumes managers as the key (and initial) actors. In this sense the core purpose of corporations law is not to declare first principles as to the power of managers, shareholders, or directors, but rather to provide a governance system for a team of contributors that works in light of the benefits of specialization in large enterprises and the challenges of monitoring agents in that setting.

Directors police conflicts of the managers and sometimes share in the exercise of corporate power where they can bring additional information or perspective to the decision. In turn, shareholders police conflicts or laxness of the board, particularly if the board is captured by management, and occasionally participate in decisions where they can provide additional information or aggregate preferences of owners that may be different than managers. Those two legal effects are commonly accepted and well-understood, but another needs to be put alongside them that has been brought into focus in the current high-profile debate as to the increased power of activist shareholders and the fear that their increased power is too short-term focused in its use. Directors, in addition to their key role in monitoring management, have an additional role to slow down shareholders’ use of their power because shareholders may sometimes be acting out of self-interest. And courts are given the power to resolve disputes where the power of the three groups intersect and are in conflict.

The result is a legal structure intentionally placed on top of a business and economic reality in which directors, managers, and shareholders are empowered to check the powers of each other with sometimes overlapping powers and have space to interact with each other and work out a solution for the team. Part IV develops dispute resolution in such a structure with specific attention to how Delaware courts perform a referee role at the boundary where the powers of the groups meet. Delaware courts have long been director-centric in their approach, in ways that seem to leave little room for direct shareholder action. But they regularly have noted the need for a balance of power and their decisions illustrate a sensitivity to keeping the shareholders in the game with room for further negotiations among the parties. What is interesting about the most recent period is that the increased space for power to be exercised by shareholders has not come from changes in Delaware law but from changes in the composition of the shareholder population and a nudge from federal regulations. But consistent with the recognition of the value of separation of power in achieving corporate purposes, activists have used this new space not to take absolute control of corporations, but rather to enhance and continue negotiations with directors over corporate policy.

II. PRIMACY AS A SIREN SONG

Corporate governance in large and sophisticated modern American corporations involves so many parties that it might seem unlikely that any one of them could have primacy, but that has not dampened a still growing literature that sees clarity coming from attributing primacy to a particular corporate actor. The term is most often affixed to shareholders or directors, often as a way ostensibly to discredit the claims of the other. But even more confusing is that the real use of the primacy label given to each of those parties seems more directed to strengthening their ability to check a third set of actors in corporations—the officers who are the corporations’ top managers—usually acknowledged to have de facto primacy in governance. This part first provides a context for shareholder and then director primacy, showing why each has developed and why neither is true. A subsequent section treats parallel primacy arguments for CEOs and other corporate players. The last section draws some generalizations as to why primacy has been so attractive to so many discussants of corporate law.

A. SHAREHOLDER PRIMACY

Shareholder primacy frames two of the most long-running debates in corporate law.\textsuperscript{10} It is one side of a regulatory debate as to how to allocate decision-making power in the corporation, facing off in this context against management authority. The classic description is that provided by Berle and Means as to the separation of management and control in which the specialization of function in the modern corporation has given managers control of a vast amount of assets contributed by others.\textsuperscript{11} Shareholder primacy is asserted to provide a means to redress that imbalance.

Shareholder primacy also defines one side of a vigorously contested debate about the purpose of the corporation. Here non-shareholder stakeholders provide the counterweight. Again Berle provides the classic frame, this time in his debate with Merle Dodd, in which Professor Berle argued for shareholders and Professor Dodd for the stakeholders as a way to insure a more public-regarding attitude of business.\textsuperscript{12} Other constituency statutes passed in the wake of the takeover rage of the 1980s illustrate a parallel stakeholder concern.\textsuperscript{13} Benefit corporations are a contemporary effort to permit other participants to limit the reach of shareholder primacy in corporations.\textsuperscript{14}

These two contexts have been frequently noted,\textsuperscript{15} but the conflict they can create has received surprisingly little attention. Some discussions of shareholder primacy fit well enough in either context but the two can work at cross-purposes as when empowering shareholders to restrain managers imposes costs on other stakeholders, so that it becomes important to identify in which of the contexts primacy is being asserted.

Part of the difficulty of understanding shareholder primacy is that the concept, like the corporate form itself, has been used for over two hundred years in a variety of relational contexts—from a time in which there was little separation of

\textsuperscript{10} See D. Gordon Smith, The Shareholder Primacy Norm, 23 J. CORP. L. 277 (1998); see also David Millon, Communitarians, Contractarians, and the Crisis in Corporate Law, 50 WASH. & LEE L. REV. 1373, 1374 (1993) (finding it clear that shareholder primacy has served as corporate law’s governing norm for much of the twentieth century).


\textsuperscript{12} Compare Adolf A. Berle, Jr., Corporate Powers as Powers in Trust, 44 HARV. L. REV. 1049 (1931), with E. Merrick Dodd, For Whom Are Corporate Managers Trustees?, 45 HARV. L. REV. 1145 (1932).

\textsuperscript{13} See, e.g., 15 PA. STAT. AND CONS. STAT. ANN. § 1715(b) (West 2013) (“[D]irectors shall not be required . . . to regard any corporate interest or the interest of any particular group affected by such action as a dominant or controlling interest . . . .”); cf. Comm. on Corporate Laws, ABA Bus. Law Section, Other Constituency Statutes: Potential for Confusion, 45 BUS. L. AW. 2253, 2268 (1980) (permitting directors to consider other interests without relating such considerations in an appropriate fashion to shareholder welfare would conflict with directors’ responsibility to shareholders and could undermine the effectiveness of the system that has made the corporation an effective device for the creation of jobs and wealth).

\textsuperscript{14} See, e.g., DEL. CODE ANN. tit. 8, §§ 361–368 (Supp. 2014); see generally Jack Markel, A New Kind of Corporation to Harness the Power of Private Enterprise for Public Benefit, HUFFINGTON POST (July 22, 2013, 2:06 PM EST), http://www.huffingtonpost.com/gov-jack-markell/public-benefit-corporation_b_3635752.html (Delaware governor’s statement that benefit corporations will “help combat the plague of short termism”).

\textsuperscript{15} Professor Bainbridge uses them to anchor his means/ends discussion. Bainbridge, supra note 2.
function in a business enterprise and most firms were closely held,\(^\text{16}\) to industrial-age enterprises in which separation was assumed but control was often vested in a small group of investors,\(^\text{17}\) to the Berle and Means world of separation between owners and managers, to a world of hostile takeovers, and then to today’s world of activist shareholders. The corporate form, and terms like primacy and shareholder wealth maximization, adapted to the various contexts in a manner that requires some effort to keep them all in an understandable perspective.

1. The Two Conceptions of Modern Shareholder Primacy

Henry Hansmann and Reinier Kraakman, in their turn-of-the-century pronouncement of the emergence of a standard model of corporate governance,\(^\text{18}\) captured the two core parts of the modern doctrine of shareholder primacy: shareholders’ “ultimate control” over the corporation;\(^\text{19}\) and the managers’ duty to put shareholders’ interests first,\(^\text{20}\) often described as shareholder wealth maximization.\(^\text{21}\) The first suggests actual shareholder decision making for the corporation, the second seems to acknowledge decision making by others—boards or officers with shareholder wealth maximization used by courts to constrain that decision making or internalized by corporate actors.

\(^{16}\) See Smith, supra note 10, at 277 passim, 322 (discussing the nineteenth century development of shareholder primacy and it roots in closely held enterprises, suggesting some skepticism about its jump to publicly held corporations, and concluding “[t]he shareholder primacy norm may be one of the most overrated doctrines in corporate law”).


\(^{18}\) Hansmann & Kraakman, supra note 1.

\(^{19}\) See John H. Matheson & Brent A. Olson, Corporation Cooperation, Relationship Management and the Triadological Imperative for Corporate Law, 78 Minn. L. Rev. 1443, 1461 (1994) (the traditional shareholder primacy model of the corporation derives from the concept that as owners of the corporation, shareholders are entirely to control its destiny, determine its fundamental policies, and decide whether to make fundamental changes).

\(^{20}\) These were the first two of the principal elements of the standard model of corporate governance that Hansmann and Kraakman found to have vanquished all competing theories. The others are that other corporate constituencies should have their interests protected by contract, nonmajority shareholders should receive strong protection, and the market value of publicly traded corporate shares is the principal measure of the shareholder interest. See Hansmann & Kraakman, supra note 1, at 441.

Lyman Johnson and David Millon provided a similar dichotomy at an earlier point distinguishing “shareholder protection” and “shareholder autonomy.” See Lyman P.Q. Johnson & David K. Millon, Misreading the Williams Act, 87 Mich. L. Rev. 1862, 1882–86 (1989). The second usage was common after the passage of the Williams Act in 1968 and through the 1980s, often in the context of an argument for federal preemption of state antitakeover law by “preserving for target shareholders the inviolable right to decide whether to accept tender offers.” Id. at 1882. The U.S. Supreme Court’s 1987 decision in CTS Corp. v. Dynamics Corp. of America, 481 U.S. 69 (1987), rejected the preemption argument. In contrast to the earlier phrasing, this article focuses on shareholder self-help rights attributable to state corporations law. See David Millon, Radical Shareholder Primacy, 10 U. St. Thomas L.J. 1013 (2013) (offering a dichotomy of “radical shareholder primacy” and “traditional shareholder primacy”).

While some uses of shareholder primacy embrace both parts (and both would seem necessary if there is to be primacy in any realistic sense), often the primacy users are really talking only about the second. There is a difference if primacy is limited only to this usage. Stephen Bainbridge, for example, clearly embraces shareholder wealth maximization and then makes that norm a foundation of his director primacy claim. It also makes a difference which of two variations of shareholder wealth maximization is meant: (a) the legal duty/judicial enforcement form that uses shareholder wealth maximization in filling out the meaning of fiduciary duty; or (b) the business school/mission statement form that shareholder wealth maximization is the proper purpose of the corporation. In the first it is left to the court to declare the parameters of shareholder primacy; in the second it is left to the business participants on the board in their decisions, business strategy, or mission statement. In either, filtering shareholder primacy through actions by directors or officers or declarations by judges means the result is usually well short of what would usually be meant by primacy.

If the focus is on duty, what is important is how judges apply corporate law, including the business judgment rule, widely acknowledged as a judicial rule of decision used to insulate director action from challenge by shareholders. The court in *Dodge v. Ford Motor Co.* provides a classic example of this use of shareholder primacy: “A business corporation is organized and carried on primarily for the profit of its stockholders. The powers of directors are to be employed for that end. . . . [I]f the avowed purpose of the defendant directors was to sacrifice the interest of shareholders, it [would be] the duty of the courts to interfere.” The Michigan Supreme Court ordered Henry Ford’s Ford Motor Company to pay a large dividend to the shareholders of his then closely held corporation. Yet the court refused to interfere with management decisions to cut the price of its cars almost 20 percent when the company could sell every car coming off the assembly line at the higher price, a plan the court acknowledged would produce a less profitable company with “the apparent immediate effect . . . to diminish the value of shares and return to shareholders.” The shareholder wealth maximization reasoning in that case extended only to requiring directors to pay dividends in the very unusual situation in which the corporation was already flush with cash and could internally finance a massive expansion while at the same time substantially reducing the price of its product, in a setting that was as close to being able to print money as a private company might find itself.

23. Bainbridge, supra note 2, at 557–58.
25. The court described Henry Ford’s testimony as creating the impression that he thinks “the Ford Motor Company has made too much money, has too large profits, and that although large profits might still be earned, a sharing of them with the public, by reducing the price of the output of the company, ought to be undertaken.” Id. at 683–84.
26. Id.
Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc. is another case frequently cited for the director’s duty to maximize shareholder profit.\(^\text{27}\) When a corporation is up for sale, the court declares the directors’ duty as getting the best price for the stockholders.\(^\text{28}\) But subsequent case law made clear that this is well short of a global duty in all takeover contexts. In Paramount Communications, Inc. v. Time, Inc., where the target board rejected a cash bid of $200 a share in favor of continuing an alternative combination with a value of much less—in the range of $120 per share—the Delaware Supreme Court declined to impose the higher scrutiny of asking if the board had gotten the best price.\(^\text{29}\) The trigger to get to “Revlonland” challenges law students and practitioners.\(^\text{30}\) Directors of a company looking at a takeover retain considerable flexibility in terms of structuring a transaction to avoid the Revlon duty of best price if they wish.\(^\text{31}\) This duty to maximize shareholder wealth is an obligation target directors can turn off or on depending on how they structure a transaction. Such shareholder primacy at the option of directors hardly seems to qualify for the name.

As identified above, shareholder wealth maximization is sometimes used in contexts outside judicial enforcement and it is worth separately examining the reach of this use in what might be termed its “mission statement” version. Lynn Stout observed that, by 1990, most scholars, regulators, and even many business practitioners had come to accept shareholder wealth maximization as the proper goal of corporate governance.\(^\text{32}\) Many of the largest American corporations, including, for example, Apple, Exxon, GE, Berkshire Hathaway, and Google, publish principles of corporate governance saying that management power is to be exercised for the shareholders.\(^\text{33}\) If the parties acting for the cor-

\(^{27}\) 506 A.2d 173, 182 (Del. 1986).

\(^{28}\) Id.

\(^{29}\) 571 A.2d 1140 (Del. 1990).

\(^{30}\) In a subsequent case, the Delaware Supreme Court applied the Revlon best price obligation to void defensive tactics used to protect a combination preferred by the board where, unlike Time, the acquiring company had a controlling shareholder. Paramount Commc’ns, Inc. v. QVC Network, Inc., 637 A.2d 34 (Del. 1994) (focusing on the acquiring shareholders’ loss of their only opportunity to share in a control premium); see also Lyondell Chem. Co. v. Ryan, 970 A.2d 235 (Del. 2009) (noting that the trigger for Revlon is not a company being in play but rather a company embarking on a transaction—on its own initiative or in response to an unsolicited offer—that will result in a change in control).

\(^{31}\) For example, they can structure a deal to have the shareholders receive stock instead of cash or by avoiding a stock deal with a company having a controlling shareholder.

\(^{32}\) Stout, supra note 22, at 3. But see Lyman P.Q. Johnson, The Delaware Judiciary and the Meaning of Corporate Life and Corporate Law, 68 T EX. L. REV. 865, 877 (1990) (“Most persons in this country probably would be astounded to hear that maximization of shareholder wealth is the reason d’etre of corporate existence.”).

\(^{33}\) The New York Stock Exchange listing standards require listed companies to adopt and disclose corporate governance guidelines. See N.Y. STOCK EXCH., LISTED COMPANY MANUAL § 303A.09 (2015). The statements below are from each company’s corporate governance principles. Apple Inc., Corporate Governance Guidelines 1 (Dec. 21, 2015) (“assures that the long-term interests of the shareholders are being served”); Corporate Governance Guidelines, ExxonMobil (July 1, 2015), http://corporate.exxonmobil.com/en/investors/corporate-governance/corporate-governance-guidelines/guidelines (“the directors’ fiduciary duty is to exercise their business judgment in the best interest of ExxonMobil’s shareholders”); GE, Governance Principles 1 (undated) (“the board of directors is elected by the shareholders to oversee management and to assure that the long-term interest of
poration believe and act on shareholder primacy, enforcement is secondary, if not unnecessary. But these documents provide a good bit of wiggle room. GE, for example, notes: “Both the board of directors and management recognize that the long-term interests of shareowners are advanced by responsibly addressing the concerns of other stakeholders and interested parties including employees, recruits, customers, suppliers, GE communities, government officials and the public at large.”34 An earlier study by Lorsch and Maclver found widespread ambivalence among directors about shareholder primacy.35 With the breadth identified here and without enforcement, this use of shareholder wealth maximization provides some guidance and even accountability, but is a long way from primacy.

2. The Normative Arguments as Shaped by Economic Theories of the Firm

The two most widespread theoretical arguments for shareholder primacy stem from economic learning developed in the mid-twentieth century.36 One thread draws on property rights and concepts of ownership and the other centers on agency costs. Milton Friedman’s 1970 essay on the purpose of a corporation captures the property roots of shareholder primacy:

In a free enterprise, private-property system, a corporate executive is an employee of the owners of the business. He has direct responsibility to his employers. That responsibility is to conduct business in accordance with their desires, which generally will be to make as much money as possible while conforming to the basic rules of society.37

Bainbridge observed that “[b]ecause private property is such a profound part of the American ethos, this model’s normative implications long dominated our approach to corporate law.”38 Other economics-based scholarship focused not on ownership of the firm, but rather ownership of residual rights as supporting the shareowners are being served”); BERKSHIRE HATHAWAY INC., CORPORATIVE GOVERNANCE GUIDELINES 1 (Jan. 28, 2014) (“On behalf of the Company’s shareholders, the Board is responsible . . . .”); Corporate Governance Guidelines, GOOGLE (Oct. 2, 2015), https://investor.google.com/corporate/guidelines.html (“These corporate governance guidelines are established by the Board of Directors . . . to provide a structure within which our directors and management can effectively pursue Google’s objectives for the benefit of its stockholders.”).

34. GE, supra note 33, at 1.
35. JAY W. LORSCH & ELIZABETH MACIVER, PAWNS OR POTENTATES: THE REALITY OF AMERICAN CORPORATE BOARDS 39–43 (1989) (majority of directors felt accountable to multiple constituencies; only a “true minority adhere to a strict belief in the primacy of the shareholder”).
38. Stephen M. Bainbridge, In Defense of the Shareholder Wealth Maximization Norm: A Reply to Professor Green, 50 WASH. & LEE L. REV. 1423, 1428 (1993) (taking a contractarian view that the firm is not capable of being owned and recommending throwing “Friedman’s concept of ownership out the window, along with its associated economic and ethical baggage”).
shareholder primacy. Easterbrook and Fischel, for example, have noted that shareholders have the appropriate incentives “to make discretionary decisions . . . . The shareholders receive most of the marginal gains and incur most of the marginal costs. They therefore have the right incentives to exercise the discretion.”

Neither variant reaches nearly far enough to support primacy. Financial theory has taught us that shareholders are not the only stakeholders with a claim to residual value. Options theory suggests that debt holders also have a claim on the residual value and parallel arguments can be made for other stakeholders.

Even if these economic arguments were sufficiently consistent to provide a theory for primacy, the law flatly contradicts shareholders’ ability to make all “gap-filling” decisions for the firm or otherwise exercise rights accruing to residual owners to control the firm as does an owner in a sole proprietorship. Instead, corporations statutes provide that all corporate power is to be exercised by, or under the direction of, the board. Thus, shareholders cannot, as a rule, force the board to issue dividends to capture that value. Instead, shareholders’ right to residual claims must be filtered through board decisions (e.g., the board’s legal right to declare dividends, distribute assets, or dissolve) or through the market (by shareholders selling shares as the means to gain liquidity for their investment).

Shareholder primacy also draws considerable strength from another foundational theory of modern law and economics—agency costs. Jensen and Meckling posit that the exchange of equity for capital establishes a principal-agent relationship between the shareholders and the board of directors. An agent, the board, will be tempted to extract private benefits using its control of the firm’s assets and therefore the principals, the shareholders, must monitor the agent to protect

44. See Easterbrook & Fischel, supra note 40, at 66.
45. See, e.g., DEL. CODE ANN. tit. 8, § 141(a) (2011) (“The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors . . . .”); MODEL BUS. CORP. ACT ANN. § 8.01(b) (2015) (“All corporate powers shall be exercised by or under the authority of, and the business and affairs of the corporation managed by or under the direction of, its board of directors . . . .”).
their interests. When investors give up control of their assets to others as part a specialization of function within a firm, they will price what they seek for their contribution based on incentives of the managers to act for investors, the available monitoring of these agents tempted to extract private benefits, and the residual risk left in the agency relationship after those incentives or monitoring are put in place. Shareholder primacy provides such a monitoring mechanism. But as Bainbridge has pointed out, “this elegant theory breaks down precisely where it would be most useful . . . . In general, shareholders of public corporations have neither the legal right, the practical ability, nor the desire to exercise the kind of control necessary for meaningful monitoring of the corporation’s agents.”

Agency law (as distinguished from agency theory in economics) endows principals with a strong right of control and imposes fiduciary duties on agents that are consistent with the economic case for shareholder primacy. The American Law Institute’s Restatement (Third) of Agency creates an agency relationship “when one person manifests assent to another person that the agent shall act on the principal’s behalf and subject to the principal’s control, and the agent manifests assent or otherwise consents so to act.” Some courts have adopted a principal-agent frame in describing shareholders’ power. Yet, American corporate law clearly refutes such a relationship. As already noted above, directors have the autonomous power to make virtually all business decisions under all of the states’ corporate statutes, which is difficult to reconcile with them being under the shareholders’ “control.” The Official Comment to section 1.01 of the Restatement (Third) of Agency (following prior Restatements) states explicitly: “Although a corporation’s shareholders elect its directors and may have the right to remove directors once elected, the directors are neither the shareholders’ nor the corporation’s agents as defined in this section, given the treatment of directors within contemporary corporate law in the United States.”

3. Shareholder Primacy as Really Intended for Something Else

As the discussion so far reveals, the theoretical arguments for shareholder primacy fall well short of giving shareholders ultimate control; corporate statutes provide rules that are flatly inconsistent with it and common law statements imposing a duty on directors to maximize shareholder wealth stop considerably short of universal application. Why then do we see such widespread use of the concept and such broad language? In one sense it may be a myth, as explored by Langevoort and others in the corporate setting, reflecting a need or desire to

49. Bainbridge, supra note 2, at 568.
50. Restatement (Third) of Agency § 1.01 (Am. Law Inst. 2006).
51. See, e.g., Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 659 (Del. Ch. 1988) (finding that judicial review of board decisions alleged to interfere with the shareholder vote “involve the determination of the legal and equitable obligations of an agent toward his principal . . . . [Shareholders are entitled] to restrain their agents, the board, from acting for the principal purpose of thwarting” shareholder action.”).
52. Restatement (Third) of Agency § 1.01 cmt. f(2).
see the world as understandable or predictable and to avoid paralyzing contra-
diction.\footnote{53} Kahan and Rock see something similar in the writings of New Dealer
Thurman Arnold about corporate personification as a ritual that lets us live in
contradiction: to let us accept the benefits of specialization and concentration
of capital essential to realizing economics of scale and still hold on to traditional
ideas like rugged individualism.\footnote{54} Applying Thurman Arnold to today’s corpo-
rate governance, they suggest “we need to believe shareholders control managers
who control huge concentrations of capital.”\footnote{55}

It is possible, too, to overread primacy—that it is not intended so much as an
absolute, but as a proxy for a relative change. Lucian Bebchuk, for example, talks
not about primacy, but rather increasing shareholder power in a relative sense,
which he advocates “to improve corporate performance and value.”\footnote{56} Hansmann
and Kraakman likewise disavow any intrinsic desire that corporations should be
run in the interest of shareholders alone: “All thoughtful people,” they tell us,
believe corporations should be run for the interests of society as a whole; but
as a consequence of logic and experience, they find a consensus that “the best
means to that end is to make managers directly accountable only to sharehold-
ers.”\footnote{57} To the extent that shareholder primacy devolves into an instrumental use
of shareholder primacy and reflects a purpose to make managers accountable,
the focus, as in Part III, should be on the interactive balance of shareholders, di-
rectors, and officers, more than a primacy-driven exercise.

\section*{B. Director Primacy}

The argument for director primacy falls out a bit differently. Here the words of
corporate statutes declare something that sounds like primacy. Delaware’s Gen-
eral Corporation Law says “the business and affairs of every corporation . . . shall
be managed by or under the direction of a board of directors.”\footnote{58} The Model Busi-
ness Corporation Act says the business and affairs of the corporation shall be
managed by the board or under its direction and subject to its oversight.\footnote{59}
But facts on the ground belie this formal statement of director primacy. First, directors lack the practical ability to be a primate. Theirs is a part-time job; they devote perhaps twenty hours a month on average, only a fraction of the time that officers and senior employees put in. There has been a move in recent decades to pay directors more and with stock that aligns their interest with shareholders, but they often can convert the stock into cash, and their incentives are much more low-powered than those of the officers who are the real managers. The disparity between directors and officers is more glaring on another key dimension to effective decision making—access to information. Again the officers have much more access to the foundational data for decision making than do their nominal superiors. To say that part-time directors with low-powered incentives and much less relative information are, in reality as distinct from legal doctrine, the primates in this governance structure is to engage in a fantasy.

American corporations recognize this reality. It has become common for large American corporations to develop, adopt, and publish on their websites their principles of corporate governance that describe their internal structures. One of the largest 250 American companies described its allocation of authority this way: “[A]ll corporate authority resides in the Board . . . . [T]he Board delegates authority to management to pursue the Company’s mission. Management, not the Board, is responsible for managing the Company.” The document does specify that the board retains specified responsibility to recommend board candidates, to select, evaluate, and terminate the CEO, and to advise management with respect to strategic plans, but that seems at some distance from primacy. It is a discontinuous exercise of legal power—perhaps more commonly exercised than the shareholders’ use of their legal power to elect and replace directors, but still decidedly intermittent in its use.

Other of our largest corporations suggest that their directors play a similar role. Microsoft’s principles of corporate governance provide that “[s]hareholders elect the board to oversee management and to assure that shareholder long-term interests are served. Through oversight, review and counsel, the Board establishes and promotes Microsoft’s business and organizational objectives.” Chevron’s document provides that the board “oversees and provides policy guidance and subject to the oversight of” that the Official Comment suggests means “operational management [can be] delegated to executive officers and other professional managers.”

60. See Lyman Johnson & Robert Ricca, Reality Check on Officer Liability, 67 BUS. LAW. 75, 80 (2011) (citing studies showing increase in director time from fourteen hours per month prior to Sarbanes-Oxley to about twenty hours through 2009); see also Usha Rodrigues, A Conflict Primacy Model of the Public Board, 2013 U. ILL. L. REV. 1051, 1062.
62. See Rodrigues, supra note 60, at 1062.
64. Id.
65. MICROSOFT CORP., CORPORATE GOVERNANCE GUIDELINES 1 (July 1, 2015), http://www.microsoft.com/investor/CorporateGovernance/PoliciesAndGuidelines/guidelines.aspx. Note the verbs used to describe the board’s roles—“oversees” business affairs, “works with management” to determine strategy,
on the business and affairs of the corporation." GE’s guidelines say its business is “conducted by its employees, managers and officers, under the direction of the chief executive officer (CEO) and the oversight of the board, to enhance the long-term value of the company for its shareholders.” These are not verbs used to describe one exercising primacy.

As a theoretical matter, board primacy has developed in two variants with substantially different implications for corporate governance. Steve Bainbridge draws on Kenneth Arrow and other threads of economic theory to argue for the value of authority and fiat in a manner that ends up being an argument for board sovereignty. Margaret Blair and Lynn Stout place director primacy within a team production theory where the board performs as a mediating hierarchy. The remainder of this part briefly summarizes each and examines the extent to which there is director primacy in the modern American corporation.

1. The Board as Exercising Fiat and Authority

Stephen Bainbridge has the more muscular of the two main director primacy arguments, making an affirmative case for the efficiency value of authority and the board being able to exercise fiat. Drawing from earlier work of Kenneth Arrow, Bainbridge sees fiat as the defining characteristic of corporate governance and its overarching value. The board executes fiat and its sovereign-like authority as part of an efficient decision-making system to reduce transaction costs associated with uncertainty, opportunism, and complexity. This economic value of fiat means boards should be viewed as acting for the entity to hire the various factors of production, rejecting a nexus-of-contracts approach to the corporation to the extent that it projects an entity with no primate.

Bainbridge, however, embraces shareholder wealth maximization (“SWM”) as a core part of his director primacy. It becomes the critical means for accountability, a concept that under an Arrowian view is reciprocal to authority and in necessary tension with it, but which cannot occur to such a degree that it imperils authority. Given those limits, Bainbridge willingly turns to courts as the instrument to implement SWM as an accountability mechanism; he minimizes shareholder self-help via voting or probably other means that would illustrate

“performs” the annual CEO evaluation, “oversees” succession planning, and “oversees” internal controls.

66. See Chevron Corp., Corporate Governance Guidelines 1 (Sept. 30, 2015), http://www.chevron.com/investors/corporategovernance/governanceguidelines/. The other verbs used with regard to the board’s functions are to “monitor” overall corporate performance and “oversee” management and plans for succession of key executives.

67. GE, supra note 33, at 1.

68. See Stout, supra note 22, at 12.

69. Bainbridge, supra note 2, at 603.

70. Blair & Stout, supra note 2.

71. Bainbridge, supra note 2, at 603.

72. Id. at 558 (finding that modern corporation’s decision-making structure precisely fits Arrow’s authority-based model).

73. Id. at 550.

74. Id. at 603.
the ultimate shareholder control prong of shareholder primacy. Indeed a key part of his director primacy argument is to counter shareholder primacy: Director primacy with its emphasis on authority and fiat provides a model for constraints on shareholder control under an efficiency justification. Even the control rights that he may concede to shareholders, such as the right to fire directors via the market for corporate control, he distinguishes from fiat, and, in any event, he explains away any real effect from that potential: "In general shareholders of public corporations have neither the legal right, the practical ability, nor the desire to exercise the kind of control necessary for meaningful monitoring of the corporation’s agents."

The fiat that Bainbridge rightfully prizes is also characteristic of CEOs and management more generally. Indeed, CEOs as sole individuals at the center of a management hierarchy, usually paid more than anyone else in the business, engrossed in the decisions of the business on a daily, hourly, and sometimes instantaneous basis, are certainly better able to exercise fiat than a collective group, many with day jobs elsewhere, coming together only a few times a year (absent a crisis), with information very dependent on managers. Directors do retain the power to terminate, which they sometimes use, and state law does provide them ultimate authority and requires that they approve some decisions such as mergers. But shareholders can replace directors and shareholders must also give their consent for a merger to be effective. Given the reality of directors' use of their governing power can it really be said that directors have the “practical ability” or the “desire” to exercise control necessary for them to be considered a primate, even with the formal statutory authority given them? As developed in Part III, directors are a critical part of governance, but a primacy label put about their shoulders has too many ways to fall off.

2. Directors as Mediating Hierarchs in a Team Production Model

Blair and Stout employ a director primacy model to solve a different problem than the fiat that drives Bainbridge. They see the corporation in a team production model where shareholders, employees, customers, and local communities each make investments in the enterprise that are firm-specific, where the inputs have particular value in this investment over some other use, and the return on the investment is not immediate, but at some point in the future. In such a setting the value of the investment, once made, can be appropriated by other participants who can behave opportunistically to renegotiate or threaten to withhold other inputs. Shareholders, like Ulysses of mythology, benefit from tying their own hands, so that other contributors will not decline to invest because of

75. Id. at 603–05 (so small as to be nonexistent).
76. Id. at 570–71 (the right to fire is not the right to exercise fiat—it is only the right to discipline).
77. Id. at 568.
79. Blair & Stout, supra note 2.
fear of misappropriation, which shareholders can do by ceding control to a mediating hierarch picked because the hierarch cannot personally profit.80

The interactive governance of shareholders, directors, and managers described in Part III has elements of team production, but the difference is not to leave all tie-breaking power in the hands of the board. The biggest challenge for a mediating hierarchs–based theory of corporate governance is that shareholders (and only shareholders) are empowered to replace the hierarch. How can you be a hierarch if one of the parties you are mediating between can kick you out? Blair and Stout do not spend a lot of time on this topic—it seems unimportant or nonexistent, perhaps in the way that Bainbridge sees the vote as so little used as to be capable of being ignored.81 But over the decade and a half since Blair and Stout’s work on team production was published, the large increase in shareholder power to throw out directors has made it much more difficult to ignore. The ability of shareholders to exercise something that looks like ultimate control of the board limits a primacy claim for directors so that this discussion fits better within a framework about shared power rather than one framed as director primacy.

C. CEO OR MANAGERIAL PRIMACY

What may now be termed managerial primacy dominated much of twentieth century corporate law and management scholarship.82 Business advisor Peter Drucker noted that directors are figureheads and shareholders are nonentities.83 Myles Mace in an extensive mid-century study of directors and governance concluded that presidents exercise de facto control and determine what directors do and don’t do.84 Both Adolf Berle and Merrick Dodd, who figured prominently in the earlier discussion of shareholder primacy, made managerialist assumptions.85

There has been both a positive and a negative aspect to discussion of managerial primacy, the former emphasizing the value that could arise from managerial primacy given economic conditions of the modern corporation, and the latter worried about the exercise of managerial power without sufficient accountability.

Alfred Chandler, in The Invisible Hand, describes the managerialist corporation of the twentieth century with administrative coordination that permitted greater productivity by lowering costs.86 William Bratton describes an unspoken bargain

80. Id. at 272.
81. See Bainbridge, supra note 2 at 569.
85. See Bratton, supra note 82.
86. Alfred D. Chandler, Jr., The Visible Hand: The Managerial Revolution in American Business 1 (1977); see also Michael C. Dorf & Charles F. Sabel, A Constitution of Democratic Experimentalism, 98 Colum. L. Rev. 267, 292 (1998) (discussing corporations that embodied an idea of efficiency as centralized, hierarchical, and vertically integrated: “as long as these worked, these features were seen as expressing basic, incontrovertible, and mutually reinforcing principles of efficiency, governance, and cognition that became synonymous with effective human action”); cf. Robert W. Gordon,
by which management would exchange stable dividends for their freedom to pursue growth; this growth bias left managers close enough to classical profit maximization for the system to be sufficiently value-creating and managers capable of statesmanship. 87 Adolf Berle, at least after he saw the impact that the New Deal’s social control over finance might have on management power, supported managerial power. 88

Some recent discussions of CEO primacy, while acknowledging that CEOs control most corporations, add the normative view that this is largely for managers’ own benefit and that society would do better with shareholder primacy or some other structure. 89 Steven Ramirez has described this as dictatorship of management, by management, and for management and laments that “at every turn, legislators, judges, and regulators have eliminated or diluted constraints on the power of management.” 90

Thomas Piketty provides a twenty-first century theoretical challenge to managerial primacy based on how much of the increase in societal inequality flows from the highest paid managers and their ability to set their own pay and extract rents from shareholders. 91 Piketty notes that with the unique job functions at the top of corporations, individual managerial production becomes harder to define; evaluating top management in these circumstances yields decisions that are largely arbitrary and dependent on hierarchical relationships and the relative bargaining power of individuals. 92

Thus, while managerial primacy remains widely accepted as a descriptive matter, few modern commentators provide a positive theory for its use and many criticize it. But there is not complete agreement about that descriptive story. Marcel Kahan and Ed Rock argue that CEOs have lost decision-making power through a combination of regulatory changes and shareholder activism. 93 Measured in terms of decision-making power, second-guessing by shareholders and the board of directors, and the scope of the CEO’s power, they see an em-

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87. Managers were not motivated primarily by profit-seeking but by power, prestige, and job security. Bratton, supra note 82, at 1494.
88. This was as opposed to early Berle who pushed more for shareholder control. William W. Bratton & Michael L. Wachter, Shareholder Primacy’s Corporatist Origins: Adolf Berle and the Modern Corporation, 34 J. Corp. L. 99, 140–44 (2008); William W. Bratton & Michael L. Wachter, Tracking Berle’s Footsteps: The Trail of the Modern Corporation’s Last Chapter, 33 Seattle L. Rev. 849, 854–58, 863 (2010) (tracing Berle’s move from the last chapter of Berle and Means when corporate managers emerged as “neutral technocrats” who come to a state-directed negotiating table where they sit down with the state and other interest groups such as labor unions to determine the public interest to a post-war view of management as non-statist civil servants. “The shareholders, earlier thrown up against Dodd as a countervailing interest, dropped out of the governance picture.”).
89. See Dent, supra note 3, at 1215 ("the status quo is . . . CEO primacy, governance by managers largely for their own benefit"); id. at 1273 ("independent boards do not control most corporations now, CEOs do").
92. Id. at 314–21.
battled CEO. But as a normative matter in their ideal corporate governance world, centralized managers remain the important decision makers: “boards would retain just that modicum of power that permits them to block, at the margin, more bad ideas than good ideas.” They acknowledge that it is “tough to know whether we are at the point” at which the net benefits of delegation are maximized such that the corporate governance debate becomes a search for the “sweet spot.” Indeed, a common aspiration for many in the various parts of the primacy debate, including shareholder primacy discussed earlier, is the search for a parallel sweet spot in a shared power structure, as developed in Part III.

D. OTHER PRIMACY THEORIES, INCLUDING EMPLOYEES AND CREDITORS

Primacy theories in corporate governance have not been limited just to shareholders, directors, or managers. Fred Tung refers to a “host of new-fangled primacies [working] their way into the corporate law lexicon.” This section focuses on two, employees and creditors, to make two larger points. First, as Tung correctly positions almost all of the new-fangled primacies, they have developed most often to challenge or distinguish shareholder primacy, often within the economic or broader debate about the purpose of the corporation. Second, as we have already seen for parts of shareholder and managerial primacy, it is difficult not to stray from pure primacy to a shared power but with greater recognition of the role of a particular group in realizing a stated purpose of the corporation.

Brett McDonnell provides an effective illustration of the first point in his argument for employee primacy. He would insert employees in place of shareholders in both parts of the traditional description of shareholder primacy. Thus, he sees ultimate employee control over corporate decision making and employee wealth maximization as the corporate objective. Employee primacy is likely to create more surplus given the strong incentives of employees and their relative wealth of information about the firm. More broadly, he argues that employee-primacy corporations are more likely to be socially responsible and, anticipating Piketty, less unequal in distribution of wealth. This, in turn, produces citizens better able to participate in political democracy.

94. Id. at 1039 (documenting, for example, the loss to shareholders and directors: “what has changed more than anything else is the ability and incentive for other players to second guess”).
95. Id. at 1049.
96. Id. at 1051.
97. Tung, supra note 5, at 817–18.
99. Id. at 339.
100. Id. at 347–64.
101. Id. at 336.
102. Id.
Henry Hansmann, who has written in various settings about different aspects of worker participation in governance, suggests such a concept is most attractive when heterogeneity is less or the need for outside financing is less. The challenge of employee primacy as a primacy theory is to explain the various contexts in which employees might have different interests from other constituents. In time of technological or market change when the firm or the economy cannot support the traditional level of wages, employee primacy may make it difficult for the firm to make adaptive decisions. Germany, and some other corporate governance systems in Europe, empower labor through a governance system of co-determination employing two corporate boards and specifying that employees are able to choose one half of the supervisory board. However, in Germany, which statutorily requires the existence of a supervisory board, legal rules do not necessarily result in employee empowerment that would suggest primacy. Hansmann notes that large German firms are often managed by a handful of shareholders who exercise control of the advisory board through coalitions and elections. The managing board, which must face reelection and the prospect of premature termination by the vote of the supervisory board, is by extension also affected by these shareholders. Co-determination today fills a smaller part in worldwide corporate governance than several decades ago, and even where it is used, it gives workers a veto over half, but not more than half, of the supervisory board as opposed to outright control that primacy would suggest.

Creditor primacy arguments likewise seek to place another constituency into the position of shareholders in the shareholder primacy model, albeit in a space that is temporally limited. Here there is a longer history of judicial support for finding that director duties shift to creditors in times of financial distress. The substitution argument is fairly straightforward—where financial reversals or risks have left the company able to pay only some financial claimants but not all of them and the shareholders’ claim (the residual claim that would be paid last) has been wiped out, it no longer seems appropriate to have the direc-

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104. Hansmann, When Does Worker Ownership Work?, supra note 103, at 1783.


106. Id. at 160.

107. Hansmann, supra note 103, at 1803.

108. Gelter, supra note 105, at 160.

tors responsive to shareholders’ interests, but rather to the financial holders who still have skin in the game.\textsuperscript{110}

While the creditors arguably have a strong claim to step into the shoes of shareholders in such a setting, they also inherit the same arguments that challenge a primacy position. Their claims are as similarly incomplete as those made against shareholders—neither may be the best residual claimants for some or all enterprises.\textsuperscript{111} The argument reduces to one of a more effective way to exercise control in particular circumstances\textsuperscript{112} with the larger theory more consistent with shared power than primacy.

\section{III. A Non-Primacy View of Corporate Governance: Intentional Sharing of Power Among Shareholders, Directors, and Officers}

As the previous part makes clear, primacy theory falls short as an accurate description of the role of shareholders or directors (or other parties) in the governance of modern American public corporations. This part suggests an alternative approach to governance based on intentionally shared power among the three actors named in American corporations statutes: shareholders, directors, and officers. Such an approach is familiar to students of American public governance where separation of power has been engrained since the founding of the republic. This first part develops the antecedents of such a philosophy and how corporate governance reflects somewhat different needs and contexts. It then develops how a shared power approach fits even within a statutory approach that vests all corporate power in the board and a legal/business environment that often explains the purpose of the corporation in terms of shareholder wealth maximization. The short answer is that law does not claim primacy for itself in terms of providing corporate governance rules, but rather recognizes the private bargaining and the market and economic realities that provide the foundation for corporate governance. Managers in the modern American public corporation provide hierarchy and efficiency, which permits officers to be the realistic starting point for corporate decisions; law structures the roles for directors and shareholders to reflect that reality. This part spells out in more detail how the specific roles assigned to both shareholders and directors under statutory policy and prevailing governance theory parallel both economic and agency theory as to roles for the key players in the corporate governance setting.

\textsuperscript{110} See N. Am. Catholic Educ. Programming Fund, Inc. v. Gheewalla, 930 A.2d 92, 1101 (Del. 2007) (creditors of insolvent corporation have standing to make derivative claims against directors).

\textsuperscript{111} See Smith, supra note 10, at 301; see also Lipson, supra note 109, at 1245 (arguing not all creditors are equal with differences as to power imbalance, volition, cognition, and ability to exit).

A. SEPARATION-OF-POWER IDEAS DRAWN FROM THE POLITY

Separation of power can be clearly seen in our public governance as a part of Madison's balance of power reflected in the structure of the Constitution.\textsuperscript{113} Commentary on corporate governance suggests that "the degree to which we ought to push for government-like procedures and legitimacy is the most important policy or normative question that lies ahead in corporate governance."\textsuperscript{114} For Madison the focus of balance of power was to produce "ambition designed to counter ambition."\textsuperscript{115} This policy of "supplying, by opposite and rival interests, the defect of better motives might be traced through the whole system of human affairs, private as well as public."\textsuperscript{116} Corporate writers frequently identify balance of power in the corporate form, as between, for example, boards and the CEO,\textsuperscript{117} shareholders and board,\textsuperscript{118} or between shareholders and management/directors.\textsuperscript{119}

Yet any such balance was for decades mostly invisible as boards were quite deferential to managers without the separateness seen in the polity. Managers frequently voted themselves onto boards and shareholders rarely showed any kind of independence.\textsuperscript{120} The numerous checks and balances of government were absent in corporations, freeing managers of the type of accountability found in political decision making.\textsuperscript{121} More importantly, the Madisonian principle of ambition countering ambition was in some ways "obviously unsuited to corporate governance . . . . [T]he corporation thrives on strong, flexible and adaptive leadership." Madison's checks and balances would supply the opposite: "a tendency to produce impasse in decision making that thwarts effective leadership."\textsuperscript{122} Yet separation of power, in a broader sense, remains a precondition for accountability in the corporate form that embraces hierarchy.\textsuperscript{123} Market and regulatory changes in the twenty-first century corporation have made separation and balance more realistic as a governance approach for these business entities. Independent directors, the expanded role for internal controls, and greater use of gatekeepers such as auditors and lawyers bolster public acceptance of the legit-

\textsuperscript{113.} See \textit{The Federalist No. 51}, at 320 (James Madison).
\textsuperscript{115.} Id. at 163.
\textsuperscript{116.} Id. at 159.
\textsuperscript{119.} See Coglianese, supra note 114, at 159.
\textsuperscript{120.} See id.
\textsuperscript{123.} See id. at 442 (emphasizing earlier pre-Madisonian sense of separation of power (based on impartiality and accountability more than checks and balances) as central to corporate self-regulation with deep roots in the republican tradition).
imacy of American corporations that have an increasingly large publicness aspect.\textsuperscript{124}

\textbf{B. SHARED POWER REFLECTED IN CORPORATIONS STATUTES AND ECONOMIC REALITIES}

Corporate statutes specifically identify three parties for corporate governance roles—managers (officers), directors, and shareholders.\textsuperscript{125} Other stakeholders have interests in, and the ability to influence, corporate decisions, for example employees, suppliers, creditors, and affected communities. But their interactions usually occur via contracts, levers provided in market interactions, or regulatory actions, not structural claims to decision making. Among the three named groups, managers make most corporate decisions, directors monitor that decision making in a discontinuous way becoming involved particularly where there is a manager conflict, and shareholders monitor director decisions, albeit in an even more limited space.

This governance structure reflects a combination of positive law and private ordering of economic relationships, a structure that facilitates separation of function in the enterprise and the economic advantages that can come from that. If one looked only at the corporate statutes, governance would be described in director primacy terms, given statutes like Delaware General Corporation Law section 141, which vests all power in the board, backed up by the deference to director decision making found in the business judgment rule that is at the heart of most judicial review in the corporate space.\textsuperscript{126} But directors delegate away most of their governance powers either expressly or by not interfering with management actions. And this pattern makes economic sense. In an enterprise taking advantage of specialization of function and the gains that can flow from that, managers devote more time to the enterprise, have more high-powered incentives to pay attention to corporate decisions, and often possess more expertise in the industry. Directors practically limit their active decision making to matters where they have a relative advantage over managers, for example where managers have a conflict. Shareholder governance, as would be appropriate for a group specializing in providing capital, is limited to an even smaller number of decisions where directors may be conflicted or captured by management or shareholders have a different view on a fundamental question such as a takeover.\textsuperscript{127}

\textsuperscript{124} See Hillary A. Sale, \textit{The New “Public” Corporation}, 2011 LAW & CONTEMP. PROBS. 137, 140; Coglianese, supra note 114.

\textsuperscript{125} See, e.g., MODEL BUS. CORP. ACT ANN. §§ 8.01 (as to directors), 7.28 (as to shareholders), 8.40 (as to officers) (2015).

\textsuperscript{126} DEL. CODE ANN. tit. 8, § 141 (2011); see ROBERT B. THOMPSON, MERGERS AND ACQUISITIONS: LAW AND FINANCE 25 (2d ed. 2014) (describing “directors rule (most of the time)” as the foremost rule of corporate law); see generally Diane Holt Frankel et al., PROCEEDINGS OF THE 2014 DELAWARE LAW FORUM: “DIRECTOR-CENTRIC GOVERNANCE” IN THE GOLDEN AGE OF SHAREHOLDER ACTIVISM, 70 BUS. LAW. 707 (2015).

\textsuperscript{127} See Edelman et al., supra note 36, at 137.
As described in more detail in the remainder of this part, the shared governance approach requires understanding how these core groups share power in a continuing interactive dance that reflects five core principles:

1. Managers are the key decision makers in corporate decisions, a point that reflects the influence of market and economic realities more than a command from law;

2. Directors have broad legal power over corporate decisions but when viewed in the economic context of modern American public corporations, the directors’ role is primarily one of monitoring managers;

3. Shareholders, with a much more limited, but still powerful, space to act under corporate law, can use their powers to provide monitoring of the board and sometimes get to express decisional preferences reflecting their financial stake in the business;

4. The board can use its broad powers to slow down the shareholders’ use of their limited powers, an allocation that reflects a need to balance the value of shareholder monitoring of conflicted or captured directors against the possibility that shareholders will sometimes be looking to use their limited power for selfish advantage; and

5. Friction among managers, boards, and shareholders will regularly play out in recurring business interactions, but courts, particularly the Delaware courts, play a role to referee disputes arising out of the exercise of power identified in points (1) through (4) above, a context that requires additional elaboration in Part IV.

1. The Starting Point of Corporate Governance: Economic Reality Makes Managers the Key Decisions Makers in a World of Specialized Inputs and Large Economic Enterprises

Managers make most corporate decisions in large American public corporations and have for almost all of the last century. This derives more from economics than law. Most state corporations statutes are virtually silent as to the responsibilities of managers, in contrast to the more fulsome authority given to directors and shareholders.128 Instead, management power flows from the specialization of economic effort facilitated by the advances of the industrial age. Centralized managers in a hierarchy provide efficiencies in information gather-

128. Delaware has but one section on officers (§ 142) and the Model Business Corporation Act a short subchapter of five sections (§ 8.40 et seq.). In twenty-first century legislation in response to financial crises, federal law has imposed significant new responsibilities on top officers, including to certify personally quarterly financial reports and responsibility for internal controls. Federal law has done what state law has not—displaced the illusion of director control over management. See Robert B. Thompson & Hillary A. Sale, Securities Fraud as Corporate Governance: Reflections Upon Federalism, 56 Vand. L. Rev. 859, 861 (2003).
ing, decision making, and implementation that autonomous small enterprises or larger entities organized via shared collective decision making among numerous, dispersed participants simply cannot match on a recurring scale.

Law does not create or mandate this specialization, but statutes and judicial decisions based on fiduciary duty do provide a legal form that facilitates it. There is a symbiotic relationship of law and markets in organizing human behavior. The purpose of corporate law is to provide a governance system that works in light of the benefits of specialization in large enterprises such as the modern American public corporation and the challenges of monitoring agents in that setting.

The corporate governance documents of large American public corporations quoted in Part II reflect this reality, as do statements of observers of this governance system. Then-Federal Reserve Board Chairman Alan Greenspan, in the run-up to the passage of Sarbanes-Oxley legislation in 2002, put the fulcrum of corporate governance squarely within the domain of the CEO, not the directors: “the state of corporate governance to a very large extent reflects the character of the CEO.”

2. Directors as Policing Agency Costs of Managers and as a Source of Additional Information, or To Be a Mediating Hierarch

Only a small subset of corporate decisions—for example, approval of fundamental changes such as mergers—actually requires board action that cannot be delegated to management and directors have reason not to exercise much of the authority they have. Large American public corporations, as evidenced by the corporate governance documents discussed in the previous part, declare such intermittent, discontinuous director decision making as their corporate policy. The obligation to pick and replace CEOs and approve executive compensation are relatively recent additions to the mandatory statutory list, but do not fundamentally alter the discontinuous nature of director decision making.

Director characteristics seem suited for such discontinuous duties. Their part-time status, usually with day jobs outside the corporation, less high-powered in-

129. See Charles R.T. O’Kelley & Robert B. Thompson, Corporations and Other Business Associations: Cases and Materials 149 (7th ed. 2014) (the corporate form can be used in entities where the same persons occupy the shareholder, director, and officer positions—think close corporations—or the public corporation where participants desire to take full advantage of that specialization).


131. See Model Bus. Corp. Act Ann. § 11.04 (2015); Del. Code Ann. tit. 8, §§ 251(b) (directors must approve a plan of merger), § 261 (same for sale of assets), § 241 (same for proposals to amend articles).

132. See Adam B. Badawi, Influence Costs and the Scope of Board Authority, 39 J. Corp. L. 675 (2014) (board will intentionally decline to exercise much of their statutory power to avoid the disruptive effects from efficiency that would flow from the increase in managers’ effort to lobby the board that would follow).

133. See supra text at notes 63–67.

134. See supra text at notes 63–67.
centives as compared to the CEO and other top managers, and lack of easy access to information about the enterprise all combine to limit their capacity to govern a large complex enterprise.\textsuperscript{135} Corporate governance theory has long-recognized these realities. For more than four decades, the primary role for a board has been as a monitor.\textsuperscript{136} This is most evident in contexts where management has a conflict of interest or other loyalty problem, but can also include monitoring of decisions involving care in the management of the firm and risk management.

There are, of course, functions of directors other than monitoring. Mid-twentieth century descriptions of board functions identified advising management as a key director function, providing management information and insights that otherwise might have been missed.\textsuperscript{137} Boards, unlike management, act collectively by a group decision, often characterized by consensus. Having multiple decision makers can lead to more information and arguably better decisions than one made by a single decision maker where the answer is uncertain but capable of a correct answer.\textsuperscript{138} Boards continue to provide such an advising and information function, but on a much reduced scale than these earlier descriptions might have suggested.\textsuperscript{139}

Blair and Stout’s team production model sees the value of the board in offering assurance to providers of firm-specific assets that decisions about the use of those assets will be made by a neutral decision maker less likely to have incentives that would distort a firm-efficient decision.\textsuperscript{140} The effectiveness of this board function turns on how often directors mediate the decisions of managers and how often other constituencies discount directors’ likelihood of not being sufficiently active to protect their interests.

3. Shareholders’ Function to Police Agency Costs, as a Source of Additional Information, and to Sometimes Express Preferences

Shareholders’ authority by statute can only be exercised on an even more discontinuous basis than the board’s authority. Their power, too, is best explained in monitoring terms, but can also be supported by some information explanations or the value of decision making by the parties who have more at risk than officers and directors. By law, shareholders can only do a few things:

\begin{itemize}
  \item[135.] See supra note 60.
  \item[136.] See Melvin A. Eisenberg, The Structure of the Corporation 165 (1976).
  \item[137.] Directors with expertise as to financing or industry knowledge might be expected to appear frequently on boards, but research shows that this is more likely to occur in firms controlled by private equity investors. See Ronald W. Masulis & Randall S. Thomas, Does Private Equity Create Wealth? The Effects of Private Equity and Derivatives on Corporate Governance, 76 U. Chi. L. Rev. 219 (2009).
  \item[138.] See Edelman et al., supra note 36, at 1380 (discussing example of decision about an action with an uncertain effect on share price where a decision made by majority vote versus one person has a higher probability of being correct); see also, Paul H. Edelman, On Legal Interpretations of the Condorcet Jury Theorem, 31 J. Legal Stud. 327, 328 (2002).
  \item[139.] See Rodrigues, supra note 60, at 1054–55.
  \item[140.] Blair & Stout, supra note 2.
\end{itemize}
• Elect/remove directors;¹⁴¹

• Approve fundamental corporate changes such as mergers but only after those changes have been proposed to them by the directors;¹⁴²

• Amend bylaws (also a shared power with directors; shareholders cannot use this authority to intrude into director authority to manage the corporation);¹⁴³

• Sell their shares, which becomes a governance tool in the context of tendering to a bidder seeking to acquire control to move the corporation in a different direction;¹⁴⁴

• File derivative suits or other litigation usually to trigger judicial review of director decision making;¹⁴⁵ and

• Inspect certain corporate records.¹⁴⁶

Millon describes such voting and informational rights as vestiges of an older age when shareholders, like partners, controlled their firms.¹⁴⁷ Perhaps that also explains Bainbridge’s dismissal of shareholder voting and Blair and Stout’s passing fairly quickly over these rights.¹⁴⁸ But it seems too cavalier to ignore so much of corporate law, particularly in a current setting where economic and market conditions have facilitated the use of these governance rights.

The principal governance use of these powers in modern American corporations is as a monitoring function similar to that just discussed for directors. Shareholders can monitor directors most often when the directors are conflicted or are captured by management. In earlier periods of corporate law, such shareholder rights were described as serving to protect shareholders’ property rights in their ownership interests in the enterprise.¹⁴⁹ It can still be argued that including shareholders in corporate decision making provides an informational advantage in certain contexts.¹⁵⁰ But the most viable and recurring use of shareholder power is to address conflicts of interest that flow from the separation of power already discussed when the board itself is tainted by the conflict or too

¹⁴² See, e.g., id. § 11.04.
¹⁴³ See, e.g., id. § 10.20.
¹⁴⁴ The right to sell is not typically in corporations statutes but rather flows from basic property rights to transfer property. See Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 659 (Del. Ch. 1988) (“Generally, shareholders have only two protections against perceived inadequate business performance. They may sell their stock (which, if done in sufficient numbers, may so affect security prices as to create an incentive for altered managerial performance), or they may vote to replace incumbent board members.”).
¹⁴⁶ See, e.g., id. § 220.
¹⁴⁷ Millon, supra note 20, at 1025, 1044.
¹⁴⁸ See supra notes 73–75 and accompanying text.
¹⁵⁰ See Edelman et al., supra note 36, at 1378.
close to management and therefore incapable of effectively providing the necessary policing.

4. Directors’ Actions to Slow Down Shareholders’ Use of Their Power

The first three principles are generally understood and longstanding in discussions of corporate governance, but this fourth one is of more recent vintage and subject to a vigorous debate. The need for a principle like this, however, is obvious given the first three. As Dr. Suess told us, if we need and employ a “bee-watcher,” we will then need a “bee-watcher-watcher” and so on and so on.151 The corporate law solution is a bit more nuanced, if less rhythmic. The shareholders can monitor the board, but what (or who) is to keep them from using their power in ways that harm other constituents, for example by electing directors who will declare large dividends or by empowering a buyer to prefer short-term profit maximization.152 In cases like Unitrin, the court emphasized the potential for shareholders to act out of ignorance,153 perhaps to take a deal with “hot” money, but the debate has moved from ignorance to encompass the fear that shareholders will more directly seek to implement strategies that benefit their own investment preferences at the expense of other constituents.154 The need now is to separate value-enhancing monitoring by shareholders from rent seeking. While it would be possible to impose fiduciary duties on shareholders, that would be messy and perhaps incomplete. Courts to this point have preferred to work this out within the space of judicial review of director power as in Blasius.155 We let the board use its authority to slow down the share-

151. DR. SEUSS, DID I EVER TELL YOU HOW LUCKY YOU ARE? 26–29 (Random House 1973) (“Out west near Hawtch-Hawtch there’s a Hawtch-Hawtcher bee watcher, his job is to watch. Is to keep both his eyes on the lazy town bee, a bee that is watched will work harder you see. So he watched and he watched, but in spite of his watch that bee didn’t work any harder not mawtch. So then somebody said “Our old bee-watching man just isn’t bee watching as hard as he can, he ought to be watched by another Hawtch-Hawtcher! The thing that we need is a bee-watcher-watcher!” Well, the bee-watcher-watcher watched the bee-watcher. He didn’t watch well so another Hawtch-Hawtcher had to come in as a watch-watcher-watcher!”).

152. See Leo B. Strine, Jr., Toward a Corporate Republic: A Traditionalist Response to Bebchuk’s Solution for Improving Corporate America, 119 HARRY. L. REV. 1759, 1783 (2006) (“a continued preoccupation solely with management’s flaws ignores the reality that the growing influence of institutional investors during the last quarter century has not been an unadulterated good”).


155. Leo B. Strine, Jr., If Corporate Action Is Lawful, Presumably There Are Circumstances in Which It Is Equitable to Take that Action: The Implicit Corollary to the Rule of Schnell v. Chris-Craft, 60 BUS. LAW. 877, 893 (2005) (“though Blasius obviously taught boards and their advisors that they must be very careful in the election context, [it] left it open to them to act so long as they were prepared to justify, in a situationally specific way, their behavior. In other words, whether or not it can be argued that the Atlas board’s actions were wrongly set aside by the Blasius decision, that decision did not totally inhibit future conduct, as the subsequent cases applying Blasius demonstrate.”).

On the larger point of the particular ability of judges, as compared to legislatures and markets, to produce legal rules that protect shareholder interests, see Jill E. Fisch, The Peculiar Role of the Delaware Courts in the Competition for Corporate Charters, 68 U. CIN. L. REV. 1061, 1086–96 (2000).
holders’ use of their “ultimate” powers, thus requiring shareholders and directors/managers to continue to talk to one another much like the divided branches of our government push back and forth, trying this or that, until they find a result that each can live with, or lets each live to fight another day with neither group getting to exercise absolute power.

This recognition of shared power was slow to get to corporate law. As previously described, shareholders have only very limited statutory and market-based powers and for most of the last century economic and market conditions were such that it was seldom worthwhile for any shareholder to actively pursue use of those powers. The Wall Street Rule was by far the dominant shareholder response—if you didn’t like the way things were going, selling via the market was the only realistic strategy. But the twenty-first century has seen the emergence of a different governance world. Shareholders are now institutions, rather than mom-and-pop individuals, often with greater economic sophistication and larger economic stakes to support their investment positions. Greater computing power has facilitated their ability to gather information and lowered the costs of communicating among like-situated investors. Institutional investors, particularly hedge funds, have developed an effective strategy to make shareholder activism pay. The government now requires many institutional investors to vote the shares they hold for beneficial owners such as shares in retirement plans, and powerful proxy advisors, such as Institutional Shareholder Services, have grown up to advise them and have become powerful players in corporate governance. This greater activism by shareholders has challenged management in a way not seen since the “raider” period of the pre-Williams Act years. Directors’ ability to slow down shareholder action has been part of a larger debate about whether shareholder activism is good for corporations and society.

5. Dispute Resolution by the Parties Themselves or by the Courts as a Referee

What should be the role of courts in this governance structure of intentionally shared authority among management, directors, and shareholders with each empowered to balance the other? Sometimes disputes between these players will get worked out by private ordering among these parties, but it should not be surprising that courts have a role in these disputes. Of course, courts are not the only possible dispute resolution mechanism; a government regulator could work out the allocation of power. In some common law countries, it is common for shareholder-director disputes in a merger context to be put to a takeovers

157. See Edelman et al., supra note 36, at 1395.
160. See Lipton, supra note 154.
panel, often made up of industry experts and participants and perhaps some
government officials.161 But in the United States, this role of resolving disputes
between shareholders and directors, particularly as to those of the type described
in point (4) above, have been left to the courts, and most particularly to the Del-
aware courts, a context that is addressed in more detail in Part IV.

IV. THE ROLE FOR COURTS IN A NON-PRIMACY CORPORATE
GOVERNANCE WORLD

When governance powers are split among different groups as in modern cor-
porations, disputes can be expected to arise at the boundary where each group’s
rights and interests intersect with the rights and interests of others. The Ameri-
can corporate law structure gives courts the principal role at these boundaries,
particularly at the boundary of shareholder and director authority.

When stakeholders other than the three named in corporate statutes raise cor-
porate governance issues, the judicial role is typically limited to interpreting con-
tracts or applying regulatory rights found in more general laws outside of the
corporations statutes. The absence of a structural role for these players in corpo-
rate law limits judicial involvement.

Even within the three named groups, if the dispute is between managers and
directors, there will be almost no judicial involvement. Managers will make most
decisions ostensibly under the direction of the board. The board retains the legal
authority to overturn every decision management makes, but realistically holds
for itself only a small subset of corporate decisions. But if the board does over-
ride the management, there is little legal basis for management to seek judicial
intervention to reverse the decision. Management will look to non-judicial chan-
nels to address its concerns about director actions.162 This ends up being less of
a legal boundary policed by the courts but rather one where boundaries are de-
defined by economic and market relationships.

At the shareholder/director boundary things are more active. Here there are
two distinct judicial roles. The first, ordinary director action fiduciary duty
claims, arises when an individual shareholder (no collective action is required)
goes to court alleging that directors or managers breached their fiduciary duty
(e.g., conflict, lack of good faith or due care).163 This has long been a core
part of American corporate law and is the most common way that courts are in-
volved in corporate governance. Judges are tasked to decide whether director
and manager actions meet long-established standards of care and loyalty for

161. See John Armour & David A. Skeel, Jr., Who Writes the Rules for Hostile Takeovers, and Why?

162. Badawi, supra note 132 (describing how managers with more intense preferences given un-
diversified human capital and typically high-powered incentives will lobby the board as to possible
board actions that may intrude on management decisions; boards will intentionally decline to exer-
cise all (or most) of the power given to them by corporate statutes to avoid being subject to more
lobbying by managers).

163. See supra Part III.B.3.
one who has control of the property of another. The second, shareholder self-help claims, arises when shareholders assert the affirmative authority to act collectively themselves, usually contrary to the board's preferences.

A. THE TWO DISTINCT JUDICIAL ROLES

The judicial role is different in these two settings just described. In the ordinary director action fiduciary duty context, the core issue is whether judges should displace director decision making. Courts regularly acknowledge it is neither their role nor their expertise to make business decisions. Judges feel comfortable evaluating conflict and process that can destroy a fiduciary's capacity to act for the entity, but stay away from the substance of business decisions. The broad control over other peoples' money given to directors and management by corporate statutes has long been understood to trigger fiduciary duties by those parties. Individual shareholders can file suit in the name of the corporation or on behalf of a class of shareholders alleging breach of such duties. Judges rule on these claims following a well-defined path: the beginning point is one of deference; courts will defer to the business judgment unless the plaintiff shows something such as conflict, gross negligence, bad faith, fraud, illegality, or waste. Upon such a showing, the court will move off of deference to a more intrusive review of the challenged act under an entire fairness or other standard. The focus here is on the board's (or management's) domain. In particular, courts focus on whether there is some reason or disability causing the board or managers to have lost the capacity to act. Courts are quick to distinguish such failures from judicial interference with the insiders' business judgments.

In the shareholder self-help context, the governance question is broader. It is not just a question of whether a judge should decline to defer to director decision making because of conflict or insufficient process or another deficiency, but whether shareholders as a matter of governance should supplant the directors and be the decision makers for the corporation even if there is no conflict or other deficiency. It is possible to use the language of the ordinary director action in the fiduciary duty context to resolve shareholder self-help claims as when both director conflict and the right to shareholder decision making appear in the

164. See RESTATEMENT (THIRD) OF AGENCY § 1.01 (2006).
165. See, e.g., the powers itemized in Part III.B.3 that reflect the limited space in which positive law authorizes shareholders to act.
168. THOMPSON, M ERGERS AND ACQUISITIONS, supra note 126, at 97.
170. See Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651, 658–59 (Del. Ch. 1988) ("The real question the case presents, to my mind, is whether, in these circumstances, the board, even if it is acting with subjective good faith (which will typically, if not always, be a contestable or debatable judicial conclusion), may validly act for the principal purpose of preventing the shareholders from electing a majority of new directors. The question thus posed is not one of intentional wrong (or even negligence), but one of authority as between the fiduciary and the beneficiary (not simply legal authority, i.e., as between the fiduciary and the world at large.").
same setting; Delaware courts in developing enhanced judicial review under Unocal\textsuperscript{171} and Revlon\textsuperscript{172} frequently discuss the conflict of directors of a target company when taking defensive tactics to fend off an unwanted takeover. The result may be to invalidate action taken by such boards that interfere with shareholder actions. But that approach gives short shrift to the distinctive governance question posed in a self-help context and how it is different from the ordinary fiduciary duty context. The first tasks courts to use fiduciary duty to protect shareholders against director or management action that does not meet traditional standards of loyalty or care and the second to leave room for shareholder self-help as an independent component of governance.

The two different kinds of judicial roles just described correspond to the dichotomy in the versions of shareholder primacy discussed in Part II. Ordinary director action in the fiduciary duty context corresponds to the older and more established version of shareholder primacy linked to the purpose of the corporation and focused on how courts ought to define that purpose in interpreting a director’s fiduciary duty.\textsuperscript{173} It also reflects the core of Bainbridge’s director primacy view that is focused on broad director authority so long as courts can use fiduciary duty with a strong shareholder wealth maximization norm to rein in director action.\textsuperscript{174} Shareholder self-help corresponds to the younger variant of shareholder primacy that extends to permit shareholders to act on their own as a recognized part of corporate governance.\textsuperscript{175} As set out in Part II, none of the primacy approaches alone has sufficient descriptive power to be the foundation of corporate governance theory, but this recognition of the two distinct ways in which the director-shareholder relationship is addressed in corporate governance contributes to the separation-of-power understanding of corporate governance.

This difference between the two distinct roles that judges are called on to perform is also reflected in judicial decisions and academic writings beyond primacy. The Delaware Supreme Court, for example, has distinguished enterprise from ownership decisions,\textsuperscript{176} as have writers in law reviews.\textsuperscript{177} Former U.S. Securities

\textsuperscript{172.} Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 180 (Del. 1986) (the “omnipresent specter that a board may primarily be acting in its own interest rather than those of the corporation or its shareholders”).
\textsuperscript{173.} See Smith, supra note 10.
\textsuperscript{174.} See Bainbridge, supra note 2.
\textsuperscript{175.} See Johnson & Millon, supra note 20.
\textsuperscript{176.} Omnicare, Inc. v. NSC Healthcare, Inc., 818 A.2d 918, 930 (Del. 2003); see also Blasius Indus., Inc. v. Atlas Corp., 564 A.2d 651 (Del. Ch. 1998) (discussing shareholder ownership rights); William T. Allen, Jack B. Jacobs & Leo E. Strine, Jr., \textit{Function Over Form: A Reassessment of Standards of Review in Delaware Corporation Law}, 26 Del. J. Corp. L. 859, 886 (2001) (noting that Blasius was a “ringing endorsement” of the need for protection of shareholder rights and that post-Blasius cases have recognized the reality that some sorting mechanism is needed to insulate from Blasius director actions “consistent with their legitimate authority”).
\textsuperscript{177.} That distinction reflects earlier writing by a Delaware chief justice in a law review about enterprise and ownership decisions. E. Norman Veasey, \textit{The Defining Tension in Corporate Governance in America}, 52 Bus. Law. 393, 394 (1997) (finding that ownership issues may sometimes implicate the traditional business judgment rule, but often ownership decisions recognize an enhanced court scrutiny that goes beyond the traditional rule). This, in turn, draws on writing by a distinguished aca-
and Exchange Commissioner Troy Paredes has made a parallel distinction between managerial control and residual control that picks up on similar themes:

The board (and the officers to whom the board delegates authority) ultimately exercises managerial control, subject to the shareholders’ residual control rights over the enterprise. Most notably, shareholders have the right to elect and remove directors, but they also have the right to sell. Shareholders have the right to sell their shares when they disapprove of the way the board and the management team are running the company or for any other reason. Not only do individual shareholders have the right to sell their shares in the company, but, at least as a default matter, shareholders have the right to sell their shares collectively so as to transfer control of the company, in effect retracting the board’s control. Indeed, alienability is typically understood to be a key feature of one’s property rights.178

At the same time, Delaware courts have avoided any clear statement on shareholder-versus-director primacy. Certainly their rulings on poison pills and in other takeover contexts reflect their longstanding adherence to a corporate governance system in which their foremost rule is to trust directors to make business decisions.179 But their jurisprudence requires room for shareholder decision making. Together these two strands cannot support a pure form of shareholder or director primacy. Indeed, the Delaware Supreme Court has noted the express balance of power that its law requires,180 an approach that supports the balancing analysis suggested here.

While there has been recognition of the two different judicial roles in refereeing shareholder and director governance roles, we should be careful not to claim too much clarity as yet. Development of the shareholder self-help prong in the law has been hampered because, for most of the twentieth century, economic realities did not permit shareholders to effectively use the self-help provided them under the law and, therefore, there was little reason for academics or judges to spend much time developing a theory. Collective action problems ef-
effectively discouraged shareholders from using their legal power. The dominant strategy for shareholders unhappy with their managers was the Wall Street Rule to simply sell their stock.¹⁸¹

Even when technology and market developments made tender offers more feasible, there was concern that bidders making tender offers would prey on shareholders of target companies to the disadvantage of those companies and greenmailers would take advantage of the developing takeover market. Federal legislation via the Williams Act required additional disclosure in those settings and added some SEC regulation of the tender offer process.¹⁸² At state law, a principal judicial focus was to permit target directors to take action to protect shareholders against such abuses¹⁸³ and, at the same time, to bolster judicial review of defensive tactics to permit some bulwark against the possibility that the directors were making arguments that they were protecting shareholders from raiders to effectively insulate themselves from any hostile bids.¹⁸⁴

Subsequent developments make those concerns no longer what they were in the early 1980s. Federal rules, for example, limit two-tier coercive bust-up takeovers as occurred in Unocal.¹⁸⁵ Institutional shareholders now occupy a much greater percentage of the shareholder census and the costs to collective action have gone down dramatically.¹⁸⁶ Delaware judicial doctrine has recognized the additional space for shareholder decision making in corporate governance.¹⁸⁷

B. SPEED BUMPS IN THE RECOGNITION OF SHARED POWER

Two historical speedbumps have slowed the development of a more coherent development of shared power governance. The first is a lingering confusion whether shareholder action by selling (tender offers) and by voting are fundamentally different in a governance context. The second is a reluctance to recognize the extent to which shareholder self-help, as provided in corporations statutes, is on the same plane as directors’ authority under section 141 of the Delaware General Corporation Law.¹⁸⁸ Put a different way, there does seem too quick a willingness to recognize director authority to make corporate decisions that trumps the various shareholder self-help powers. The context underlying each of these questions has changed over the last twenty-five years, both in the legal rules provided by Delaware law and in the market forces that shape

¹⁸¹. See Donald E. Schwartz, In Search of Corporate Soul, The Structure of the Corporation: By Melvin Aron Eisenberg, 87 YALE L.J. 685, 688 (1978) (describing Wall Street Rule that unhappy shareholders sell rather than seeking alternatives such as vote).
¹⁸⁶. See Edelman et al., supra note 36, at 1397–1401.
¹⁸⁷. See infra notes 221–24 and accompanying text.
what shareholders can do. Both make more sense within an approach to corpo-
rate governance that recognizes the benefits of shared and balanced power
among the three different corporate constituents named in the corporations
statutes.

1. Shareholder Action by Tender Offer vs. Voting

The limited powers given to shareholders in corporate governance include the
power to vote their shares to replace directors or to sell their shares, including
selling collectively to a bidder who will thereby acquire sufficient shares to con-
trol the company. Delaware has struggled to articulate how those two share-
holder powers fit within a unified corporate governance regime, having for
many years preferred voting over selling in the hierarchy of shareholder powers,
but not necessarily explaining the difference.

Recall that unfavorable market conditions made conditions for shareholder
selling unfavorable for much of the twentieth century (and the prospects for vot-
ing may not have seemed much better). When market changes occurred, one
Delaware response was to treat the two forms of shareholder action in parallel.
That can be illustrated by two decisions issued by Chancellor William Allen
months apart in 1988, one addressing director action to block shareholder sell-
ing into a tender offer and the other director action to block shareholder voting.
In the voting case, Blasius Industries, Inc. v. Atlas Corp., the target board had in-
creased the size of the board to block or delay an insurgent buyer from acting by
written consent to gain control of the board and change the corporation’s
policy.189 In City Capital Associates Ltd. Partnership v. Interco, Inc., the target
board used a poison pill and then a restructuring (e.g., selling off assets and bor-
rowing money to provide a big cash payout to shareholders) to effectively block a
tender offer that would have provided $74 cash for shares that had been trading
in the $40s.190 Chancellor Allen approached the voting and selling settings in
remarkably similar fashion. In Blasius, he posed the question as whether the
board may validly act for the principal purpose of preventing the shareholders
from electing a majority of new directors if the board’s action was in good
faith and not selfish.191 The chancellor found that “the shareholder franchise
is the ideological underpinning upon which the legitimacy of directorial
power rests”; he described the Blasius context as one “involving allocation, be-
tween shareholders as a class and the board, of effective power with respect to
governance of the corporation” that he distinguished from other forms of corpo-
rate action that may have an entrenchment effect—such as the stock buyback
present in Unocal and other prior Delaware cases.192

Later that year in addressing the poison pill defense to block shareholder sell-
ning, and applying the still new Unocal test of enhanced scrutiny (he termed Unocal

189. 564 A.2d 651 (Del. Ch. 1988).
190. 551 A.2d 787, 794 (Del. Ch. 1988).
191. Blasius, 564 A.2d at 658.
192. Id. at 660.
“the most innovative and promising case in our recent corporate law”), 193 Chancellor Allen declared “there may come a time when a board’s fiduciary duty will require it to redeem the rights and to permit shareholders to choose.” 194 In finding that there was no threat as required by the enhanced scrutiny of Unocal, the chancellor observed that “the only function left for the pill at this end state is to preclude the shareholders from exercising a judgment about their own self-interest that differs from the directors who have some interest in the question.” 195 In language that echoes the legitimacy foundations of Blasius, he concluded that result “would, it seems, be so inconsistent with widely shared notions of appropriate corporate governance as to threaten to diminish the legitimacy and authority of our corporate law.” 196

There was no Delaware Supreme Court review in either case (no appeal being taken), 197 but in the years to come that court carved out separate paths in the two areas. In Paramount Communications, Inc. v. Time, Inc., the supreme court rejected the chancellor’s analysis in Interco as to what would satisfy the “threat” prong of the Unocal test as a “fundamental misconception” of Unocal. 198 The flaw, as identified by the supreme court, was that “it would involve the court in substituting its judgment as to what is a ‘better’ deal for that of a corporation’s board of directors.” 199 The result has been that a board may use a poison pill to block a bid irrespective of stockholders’ desire to accept it. 200 In contrast, Blasius subsequently received a more positive reception from the supreme court. In 1992, it accepted “the basic tenets” of Blasius 201 and has applied the Blasius holding to strike down director actions and let shareholders decide on whether to accept a takeover. 202 The result was enhanced protection for shareholder voting over shareholder selling (and more specifically only one kind of voting when shareholders vote to elect directors). In contrast a wide berth was given to boards to block selling by use of poison pills and other defensive tactics.

193. Interco, 551 A.2d at 796.
194. Id. at 798.
195. Id. While acknowledging that “perhaps there is a case in which it is appropriate for a board of directors to in effect permanently foreclose their shareholders for accepting a noncoercive offer . . . the threat here is far too mild to justify such a step.” Id.
196. Id. at 800.
197. Although winning an injunction against a poison pill and receiving tenders for a large majority of Interco shares, the bidders declined to go forward. The plaintiffs would have had to challenge another ruling of the chancellor that had permitted Interco’s restructuring to go forward that would have dramatically changed the financial attractiveness of the company to be acquired. Further, the bidders’ financial backers, Drexel Burnham and Michael Milken, were facing legal challenges of their own. See Thompson, Mergers and Acquisitions, supra note 126, at 257.
198. 571 A.2d 1140, 1152 (Del. 1989).
199. Id. at 1153.
201. Stroud v. Grace, 606 A.2d 75, 91 (Del. 1992) (accepting basic tenets but declining to apply them where it could not be said that the primary purpose of the board’s action was to interfere with or impede exercise of the shareholder franchise).
202. MM Cos. v. Liquid Audio, Inc., 813 A.2d 1118 (Del. 2003) (striking down defensive measures that changed the size and composition of the board taken for the primary purpose of impeding the shareholders’ right to vote effectively in impending election for successor directors).
Explanations for the difference between shareholders acting by voting and by selling have been sporadic. Delaware Supreme Court Justice Jack Jacobs, sitting by designation as vice chancellor in a 2004 case, *In re Emerging Communications, Inc. Shareholders Litigation*, cited an earlier chancery case acknowledging arguments that the “tender offer form is more coercive” for the receiving shareholders than merger votes. That opinion stated that a tender offer should not be treated “as the equivalent of an informed vote,” pointing to materially different interests at stake when tendering as opposed to voting such as shareholder vulnerability to being frozen out at an even lower price after a tender offer.

As market conditions have developed over the last three decades, shareholders have moved back and forth between the two channels of voting and selling, regularly combining them, for example, by using a proxy fight to replace directors who can then act to redeem poison pills that would then permit shareholder action to accept a hostile tender offer. In that context, prior distinctions between the two forms of action make less practical sense.

In addition, Delaware courts in a series of cases sometimes grouped under the *Siliconix* label have used fiduciary duty law to address the perceived shareholder vulnerability in tendering. These cases hold that a fairness review under fiduciary duty law is available to protect minority shareholders acting in response to a tender offer by a controlling shareholder unless certain conditions have been met. These conditions, in effect, would replicate the core of protections for shareholders in an arm’s-length merger—action by independent directors and by a majority-of-minority shareholders. In addition, the controlling shareholder must agree to consummate a short-form merger promptly after increasing its holdings above 90 percent, protecting non-tendering dissenters from not getting equivalent consideration.

204. Id. at *31 (quoting *In re Pure Res., Inc. S’holders Litig.*, 808 A.2d 421, 442–43 (Del. Ch. 2002)).
205. Id. Shareholders receiving a tender offer lack the shareholder voters’ ability to vote no and still get the transactional consideration or pursue appraisal under section 262, which does not include tender offers in its list of events triggering those statutory rights. *Del. Code Ann.* tit. 8, § 262 (2011).
207. From a perspective of the practical impact on what the defensive tactics made the shareholders do differently, the defensive tactics struck down in the voting cases (which get the enhanced judicial protection) seem to cause noticeably less displacement of shareholder power than the tactics upheld in the selling cases. For example, extra seats added by the board in MM Cos. meant that the insurgent shareholders would face a five–two deficit on the board for the next governance period instead of a three–two deficit. That is to say they were being deprived of being a larger minority but not being deprived of control (and if the insurgents were successful in passing an additional bylaw proposal to amend the bylaws to add four additional seats they would have had a majority of the board in either case). See MM Cos., 813 A.2d at 1123. In contrast, the board declining to redeem the poison pill in *Interco* meant the insurgents who received a large majority of shares tendered into their offer could not translate that majority into effective control indefinitely.
209. Id. at 445.
211. See id. Some Delaware chancery court decisions have called for a unified construct to address tender offer and mergers. See, e.g., *In re Cox Commc’ns, Inc. S’holders Litig.*, 879 A.2d 604, 642–48.
The Delaware legislature has now acted to treat tendering and voting as similarly able to demonstrate the shareholder consent needed for fundamental changes such as mergers or takeovers via tender offers. The Delaware merger statute permits a new form of “intermediate merger” that can be accomplished without a shareholder vote if the acquiring party acquires sufficient shares via a tender offer. The recognition of shareholder action by selling reflects a significant move toward a parallel recognition of the two forms of shareholder action and together with the common-law Siliconix cases should provoke the Delaware courts to rethink the traditional distinction between board defensive actions targeted to shareholder selling and those relating to shareholder voting.


The balance-of-power approach to corporate governance recognizes two core mechanisms providing checks on management power. Judges use fiduciary duty and accompanying legal doctrines both when shareholders assert the claim that directors or officers have misused authority given to managers to take action for the corporation and in the more particular setting where shareholders allege the director actions prevent shareholders from exercising the authority given directly to them by corporate law. The powerful lever wielded by judges under traditional application of fiduciary duty law sometimes makes them vulnerable to the mentality of a carpenter with a hammer to whom every problem seems like a nail. Their inclination can be to view every problem as one calling for a decision by a judge to protect shareholders as opposed to focusing on shareholders acting for themselves.

This can be seen in Paramount Communications, Inc. v. Time, Inc., another of the classic takeover cases of the 1980s. There the court disapproved of the chancery court’s approach in Interco and labeled Interco a “fundamental misconception” of Delaware’s standard of review under Unocal “principally because it would involve the court in substituting its judgment as to what is a better deal for that of the corporation’s board of directors.” Using a template familiar to the ordinary director action fiduciary duty context, the court focused on limited judicial

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212. See Del. Code Ann. tit. 8, § 251(h) (Supp. 2014). A 2014 amendment extended this right to use tender offers to an interested shareholder, a context that had been excluded in the original amendment to section 251(h). Fiduciary duty obligations remain for controlling shareholders in the tender offer portion of the transaction and appraisal remains available to dissenting shareholders in the merger portion of the transaction.


214. Id. at 1153.
power in reviewing the board’s business decision: “the precepts of the business judgment rule militate against a court attempting to appraise or evaluate the relative merits of a long term versus short term investment goal for shareholders.”

Of course, Paramount Communications was only addressing judicial review under Unocal, a form of intermediate review triggered by the perceived incompleteness in then-prevailing applications of judicial review of some board actions where there is the omnipresent specter that a board may be acting primarily in its own interest, rather than those of the corporation and its shareholders. A different approach should apply where the primary question is not judicially enforced fiduciary duties as the only governance protection for shareholders, but where the shareholders seek to use the specific governance powers of voting and selling provided to them. But Paramount Communications, a 1980s decision in the still early development of takeover jurisprudence, conflates these two protections in rejecting Paramount’s argument that the action of the Time board precluded Time shareholders from accepting a control premium. Here the court returned to its “fundamental misunderstanding” approach to tell the chancery court where the power of corporate governance lies: “Delaware law confers the management of the corporate enterprise to the stockholders’ duly elected representatives.”

The evolution of market conditions and regulation in the time since Paramount Communications, as discussed above, have reduced the need to rely solely on judicial use of the fiduciary duty tool and increased the space and effectiveness of shareholders using their self-help powers to vote and sell. The next section identifies this later development within the context of a shared-power approach that has developed over the last three decades.

C. Judicial and Investor Acceptance of Shared Power

In the decades since the Paramount Communications decision, courts have embraced more explicitly a balance-of-power approach to corporate governance. This can be seen in the specific context of each of the shareholder powers outside of litigation discussed above:

- The Delaware Supreme Court has recognized that shareholders’ statutory right to have the final say on mergers means that “the Delaware corporations law expressly provides for a balance of power between boards and stockholders”.

215. Id.
217. Paramount Commc’ns, 571 A.2d at 1154.
218. Id. (“The fiduciary duty to manage a corporate enterprise includes the selection of a time frame for achievement of corporate goals. That duty may not be delegated to the stockholders.”).
220. See supra Part III.B.3.
Shareholders have the power to adopt, amend, or repeal bylaws and the Delaware Supreme Court has recognized that “both the board and shareholders, independently and concurrently, possess the power to adopt, amend and repeal the bylaws”;222

Shareholders have the right to elect or remove directors, which has been described in balancing terms: “Maintaining a proper balance in the allocation of power between the stockholders’ right to elect directors and the board of directors’ right to manage the corporation is dependent on the stockholders’ unimpeded right to vote effectively in an election of directors”;223 and

Shareholders have the right to sell their shares and courts have recognized the interconnectedness of voting and selling (although courts broadly permit defensive tactics to selling such as poison pills).224

Decisions in this self-help space are different than the ordinary director action fiduciary duty cases discussed above. The decisions are not simply a question of a court substituting its judgment as to what is a “better deal” for that of the corporation’s board of directors (which the courts have long been averse to doing under the business judgment rule), but whether shareholders are able to substitute their judgment of a “better deal.”

Of course, balanced power is not necessarily equal power and Delaware courts have interpreted director power in a way that seems skewed toward directors and away from shareholders. There is an acknowledged reluctance by the Delaware courts to use the Blasius line of cases, the most visible cases upholding shareholder power.225 The benefit to shareholders of the Unocal line of cases, once seen as innovative, has shrunk over time as the threat prong of the Unocal test seems to be satisfied by almost anything and the only bite in its second prong—“preclusive or coercive”—has been read only to cover actions that seem to completely prevent shareholder action by selling or voting.226 The effect of the combination of these two trends is illustrated by the juxtaposition of the reasoning in Unitrin. There, the Delaware Supreme Court declined to apply the more enhanced scrutiny of Blasius to board defensive tactics where it found the shareholders were

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222. CA, Inc. v. AFSCME Emps. Pension Plan, 953 A. 2d 227 (Del. 2008) (recognizing shareholder bylaws cannot improperly intrude on the directors’ power to manage the corporation’s business and affairs under Delaware General Corporation Law section 141, but that the proposed bylaw in the case—providing reimbursement of a shareholder’s proxy expenses in seeking to elect directors—did not invade the director realm).


224. Stroud, 606 A.2d 75.

225. See Yucaipa Am. Alliance Fund II, L.P. v. Riggio, 1 A.3d 310, 330 (Del. Ch. 2010) (“the trigger under Blasius is as extreme as the standard it invokes. . . . [T]his Court has noted that the non-deferential Blasius standard of enhanced judicial review, which imposes upon a board of directors the burden of demonstrating a compelling justification for such actions, is rarely applied either independently or within the Unocal standard of review.” (quoting Williams v. Geier, 671 A.2d 1368, 1376 (Del. 1996))).

perfectly capable of protecting themselves by exercising their right to vote in an
election of directors. Yet, just a few paragraphs later the court found those
same shareholders sufficiently incapable of protecting themselves so as to autho-
rize the board to take defensive tactics, making it much more difficult for share-
holders to act in opposition to directors. There should be a higher burden to
characterizing shareholders as both smart and dumb in such close proximity.

Yet even while not embracing broad rights for shareholders, Delaware courts
have consistently recognized the importance of keeping all players in the game,
certainly an important precondition to a balance-of-power approach. For exam-
ple, in Moran, the Delaware Supreme Court approved the board’s adoption of the
then new poison pill that in the time since that decision has proven to be the
most consistent weapon for insiders to fend off an unwanted takeover. But
the court required that the board’s later failure to redeem the poison pill be tested
by its fiduciary duties at the time of its decision not to redeem. The result was
to preserve a channel for shareholder action—shareholders could use the vote to
replace the board which could then redeem the poison pill under the redemption
feature that was (and is) common to most pills. Then Vice Chancellor (and
later Supreme Court Justice) Jacobs in Carmody recognized that Delaware courts
are “extremely reluctant” to order redemption of poison pills so long as at least
one other avenue of shareholder action remains available and the Delaware
Supreme Court cited this with approval a dozen years later.

This is not endorsement of that line of cases. The space left for shareholders to
act has sometimes been so small as to seem invisible. The standards for applying
the most intense review—Blasius—have lacked guidance so that it seldom gets
applied. The Unocal test, “the most attractive” alternative vehicle in the ab-
sence of Blasius,236 has had its component parts eroded so that most anything satisfies the threat prong of the test237 and the only real bite of the proportionality prong is in “preclusion,” seemingly only met if all remaining shareholder channels are closed. It is not surprising that Chancellor Chandler in a context where he concluded that a target’s poison pill had served “its legitimate purpose” and that a sophisticated and well-informed shareholder base knew “what they needed to know . . . to make an informed decision” still felt constrained by Delaware law to let the board block the hostile bid irrespective of stockholders’ desire to accept it.238

Delaware courts have long preferred a court-centric use of fiduciary duty as the solution to governance problems and to start from a point of trusting directors.239 As a result, they have been slow to embrace shareholder self-help that is clearly set out in the Delaware General Corporation Law and now enabled by recent changes in the makeup of the shareholder group and the incentives of shareholders to engage in governance. In this new world, the uncertainty that has characterized the Blasius trigger and the narrowness now reflected in Unocal seems to close off too much of the balance of power that is reflective of modern corporate governance.

There are cases that recognize shareholder self-help, such as the chancery court decision raising a Revlon claim in a takeover of The Topps Company. Then-Vice Chancellor Strine found a likely Revlon violation from the target company’s declining to waive a standstill agreement with a potentially higher bidder at a time when a merger vote was scheduled on a bid management preferred.240

The solution to this breach was an injunction against the standstill to permit the

236. Id.

237. Air Prods. & Chems., Inc. v. Airgas, Inc., 16 A.3d 48, 56–57 (Del. Ch. 2011) (“Although I have a hard time believing that inadequate price alone (according to the target’s board) in the context of a non-discriminatory, all-cash, all-shares, fully financed offer poses any ‘threat’—particularly given the wealth of information available to Airgas’s stockholders at this point in time—under existing Delaware law, it apparently does. Inadequate price has become a form of ‘substantive coercion’ as that concept has been developed by the Delaware Supreme Court in its takeover jurisprudence. That is, the idea that Airgas’s stockholders will disbelieve the board’s views on value (or in the case of merger arbitrageurs who may have short-term profit goals in mind, they may simply ignore the board’s recommendations), and so they may mistakenly tender into an inadequately priced offer. Substantive coercion has been clearly recognized by our Supreme Court as a valid threat.”).

238. Id. at 57–58 (“That being said, however, as I understand binding Delaware precedent, I may not substitute my business judgment for that of the Airgas board. The Delaware Supreme Court has recognized inadequate price as a valid threat to corporate policy and effectiveness. The Delaware Supreme Court has also made clear that the ‘selection of a time frame for achievement of corporate goals . . . may not be delegated to the stockholders.’ Furthermore, in powerful dictum, the Supreme Court has stated that “[d]irectors are not obliged to abandon a deliberately conceived corporate plan for a short-term shareholder profit unless there is clearly no basis to sustain the corporate strategy. “Although I do not read that dictum as eliminating the applicability of heightened Unocal scrutiny to a board’s decision to block a non-coercive bid as underpriced, I do read it, along with the actual holding in Unitrin, as indicating that a board that has a good faith, reasonable basis to believe a bid is inadequate may block that bid using a poison pill, irrespective of stockholders’ desire to accept it.” (quoting Paramount Comm’ns, Inc. v. Time Inc., 571 A.2d 1140, 1154 (Del. 1989))).

239. THOMPSON, Mergers and Acquisitions, supra note 126, at 25 (the foremost rule of the Delaware courts to trust directors).

Topps shareholders, receiving full information, to “rationally decide for themselves between two competing, non-coercive offers.”

This is not to say that shareholders will always get it right (just as directors or managers will not always get it right). The rise in the price of Airgas in the period after the poison pill was upheld provides ex post evidence that the company and its shareholders could have been better off with the board’s rejection. After-the-fact performance of Time, Inc. can be used to argue that the company and its shareholders were substantially worse off given the board decision to reject the Paramount offer. What is at issue here is whether Delaware’s traditional approach to leave very little room for shareholder self-help still is appropriate.

The possible narrowness of Delaware’s judicial balancing has shrunk in recent years as market and regulatory changes have broadened the avenues available to shareholders. Classified boards, long one of the most effective bulwarks of directors’ ability to forestall contrary action by shareholders, have disappeared in most large public corporations, a result that reflects shareholder market power and activism beyond the courts. Individual shareholders or groups have used proxy access provided by Rule 14a-8 to include a non-binding shareholder vote on the agenda of an annual meeting (as part of the company’s proxy). Institutional shareholders, whose incentives to be activist in matters of corporate governance have been traditionally suspect, have voted for such proposals to the extent that many proposals gain more than 50 percent support of the voting shareholders.

For many years, management was able to effectively ignore such votes, even when they garnered more than 50 percent of the votes as they were non-binding. But then proxy advisory firms such as Institutional Shareholder Services arose, and otherwise passive institutional investors were willing to vote against directors at a subsequent annual meeting. This combination, indirect and multi-step as it was, produced a credible threat to management leading to management’s proposing or supporting binding action to amend the firm’s articles to remove the staggered board provisions.

Shareholders now have a parallel and indirect ability to participate in governance regarding executive compensation, through the precatory voting requirements of Dodd-Frank on that topic and the increased willingness of

241. Id. at 91.
242. See Lipton, supra note 154 (providing data on McGraw Hill after its “just say no” to American Express in 1979).
243. In re Time Warner Inc. Sec. Litig., 9 F.3d 259, 262 (2d Cir. 1993) (describing how Time stock later suffered when the company could not deliver on anticipated global alliances to pay off the large debt incurred in the reconfigured Warner deal and had to issue additional stock in the public market driving the price down).
244. 75% of 2014 Engagements Have Already Produced Agreements to Declassify: Towards Declassification at 100 S&P 500 and Fortune 500 Companies, SHAREHOLDER RTS PROJECT (Mar. 11, 2014), http://srp.law.harvard.edu/newsletters/3-11-2014_SRP_newsletter.shtml.
246. THOMPSON, MERGERS AND ACQUISITIONS, supra note 126, at 230–32 (noting greater use of shareholder “persuasive” channels).
247. See Randall S. Thomas et al., Dodd-Frank’s Say on Pay: Will It Lead to a Greater Role for Shareholders in Corporate Governance?, 97 CORNELL L. REV. 1213, 1217 (2012); Dodd-Frank Wall Street Re-
institutional shareholders to use their voting power to support greater responsi-

siveness on this issue facilitated by the activism of shareholder advisors like In-

stitutional Shareholders Services. Shareholder access to director nominations is also growing through use of Rule 14a-8 and the more active involvement of institutional shareholders.

What is important for this article regarding those changes is what institutional shareholders are doing with their broader powers. The most prevalent approach is not to use them to replace management in one fell swoop as might have occurred in 1968 or 1983, but something that clearly resembles a shared balance-of-power approach. Institutional shareholders have embraced a strategy of influence and dialogue, rather than conquer and burn. Activist shareholders have the ability and the votes to take over companies but they regularly refrain from the use of this power to turn out incumbent managers. Shareholders seem comfortable with divided government, a message we often see delivered in our polity. In Liquid Audio, for example, a Delaware case presenting the current state of play on the Blasius line of cases, the shareholders backed insurgents for the two seats up for election on the company’s staggered board but voted down a bylaw amendment that would have increased the size of the board and provided the insurgents a clear majority. In that case as well as others, the vote followed a divided recommendation from Institutional Shareholders Services, so it is worth examining the impact of proxy advisory firms on the process. The prevalence of short-slate proposals by activist shareholders to gain representation but not control of the board illustrates a similar preference for shared power.

Kahan and Rock have explored what they see as the “odd reluctance” of share-

holder activists to pursue issues that have a more material impact on governance and instead pursuing matters that seem small or irrelevant, shying away, for example, from mandatory bylaw proposals that would bring additional power to shareholders. Their examples include shareholder activists pursuing a share-

holder proposal to redeem an existing poison pill provision but would not pre-

vent the board’s future adoption and use of a poison pill with a result that the proposal would “have no impact on the company’s ability to resist a hostile bid.” They offer a variety of explanations, including a focus on “big picture” approaches such as shifting management’s conception of the board to a more shareholder-centric view, or public choice theories of the roles of proxy advisers and other players that also could impact such choices. But their preferred expla-
nation can fit into the approach suggested here. The shareholders recognize, as did Thurman Arnold during the New Deal, that society needs a ritual to deal with the contradiction of the social reality between the recurring desire to attack bigness and the benefits that come if large enterprises flourish. The end game they take from Arnold fits within a shared power approach by providing space for the key players to figure out how to make institutions serve social needs.255

CONCLUSION

As market and technological development regarding corporate governance continue apace, the primacy discussion is different than a decade or two ago. Shareholders now monitor to address conflict situations (courts do not have a monopoly on this) and also retain the right to speak for themselves, even in the absence of traditional insider incapacity that would generate judicial intervention in director decisions. But when shareholders engage in such self-help, they may be harming others. Modern corporate governance has evolved to preserve shareholder monitoring, but to let directors slow it down. This necessarily invokes an explicit system in which the different actors in corporate governance check each other.

A generation ago Delaware permitted director action to close off the selling channel for shareholder action via judicial approval of poison pills in almost any context and shutting down much of the voting channel as well. That seems to have created less space for shareholder action than specified by the corporations statutes. In the years since, the antidote to this narrowness has come not from judicial decisions, but from market and economic forces that have empowered shareholders in ways not anticipated in the 1980s or 1990s. Activist shareholders have taken to these new possibilities, but have not used them to their maximum degree. Instead we live in a corporate governance world in which shareholders want influence and voice, but not necessarily control. They will use any levers, including those that might be labeled ultimate control, to ensure space for a conversation that continues to take advantage of the hierarchy and efficiency of management, while subjecting that decision making to a shared power structure in which management continues to have the central role but not absolute primacy. There remains an important role for judges in this shared power world, but it requires a greater recognition of the self-help that the corporations statutes permits shareholders and a more transparent reasoning process in the set of cases in which shareholder self-help powers conflict with director efforts to slow down the use of that power.

255. Id.