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# Shareholder Primacy as an Untenable Corporate Norm

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# Shareholder Primacy as an Untenable Corporate Norm

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## ABSTRACT

A seminal case in corporate law, *Dodge v. Ford Motor Co.*, set the cardinal principle that corporations must serve the interests of shareholders rather than the interests of employees, customers, or the community. This principle, referred to as “shareholder primacy,” has been considered a tenet of the fiduciary duty owed by corporate directors. The shareholder primacy norm has influenced corporate behavior and encouraged short-term profit-seeking behavior with significant social ramifications. Corporations have been criticized for undermining the interests of employees, customers, and the community in the name of profit maximization. This monograph argues that corporate interests and broader social interests, such as benefits to consumers and employees, are not mutually exclusive and can be reconciled by allowing corporate managers and majority shareholders to define corporate interests more broadly, beyond the narrow confines of shareholder primacy.

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# 1

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## Introduction

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Corporations, business entities that are granted a separate legal personality through incorporation, play a vital role in our society today.<sup>1</sup> Corporations create a majority of the jobs and produce most of the goods and services, but their influence goes well beyond the economic sphere: corporations, with their economic leverage, also affect social affairs and influence local, state, and national politics both domestically and internationally.<sup>2</sup> The world’s largest corporations, those with international operations, called “multinational enterprises” (MNEs), have

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<sup>1</sup>See, e.g., Dambisa Moyo, *How Boards Work* 14–15 (2021); Phillip I. Blumberg, *The Role of the Corporation in Society Today*, 31 THE BUS. LAW. 1403, 1403 (1976). Throughout this monograph, the terms “corporation,” “company,” and “firm” are treated synonymous. The terms “officer” and “manager” are also used interchangeably without distinction.

<sup>2</sup>Blumberg, *supra* note 1, at 1403; Alexander Hertel-Fernandez, *Who Passes Business’s “Model Bills”?* Policy Capacity and Corporate Influence in U.S. State Politics, 12 PERSP. ON POL. 582, 582 (2014) (discussing corporation influence on state politics); Lenore Palladino, *The American Corporation is in Crisis—Let’s Rethink It*, BOS. REV. (Oct. 1, 2019), <https://bostonreview.net/forum/lenore-palladino-rip-shareholder-primacy/> [<https://perma.cc/6HHX-ZA25>] (less than 1% of businesses employ over half of employees); Lou Pingeot, *Corporate Influence in the Post-2015 Process* 5, 8 (Global Policy Forum *et al.* Working Paper 2014), [https://archive.globalpolicy.org/images/pdfs/GPFEurope/Corporate\\_influence\\_in\\_the\\_Post-2015\\_process\\_web.pdf](https://archive.globalpolicy.org/images/pdfs/GPFEurope/Corporate_influence_in_the_Post-2015_process_web.pdf) [<https://perma.cc/87V6-5H99>].

sales figures that are larger than entire economies of many sovereign states.<sup>3</sup> Corporate interests influence domestic legislative processes as well as bilateral and multilateral treaty negotiations, shaping the world in which we live.<sup>4</sup>

The substance of corporate interests, and the manner in which corporations promote them, greatly affects our economic, social, and political lives.<sup>5</sup> The widely accepted primary purpose of corporations is to maximize profit<sup>6</sup> or value to shareholders, otherwise known as “shareholder primacy.”<sup>7</sup> Shareholder primacy represents not only the prevalent objective of corporations but also a norm: a seminal case in corporate law, *Dodge v. Ford Motor Co.*, set the cardinal principle that a corporation must serve the interests of shareholders rather than the interests of its employees, customers, or the community.<sup>8</sup> In this case, the Supreme Court of Michigan found that the corporation’s

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<sup>3</sup>As of 2016, the world’s 100 largest economies included 31 countries and 69 companies measured by gross domestic product (GDP) for countries and by the sales figures for companies. Daniel C.K. Chow and Thomas J. Schoenbaum, *International Business Transactions: Problems, Cases, and Materials* 23 (4th ed. 2020).

<sup>4</sup>See Adam Winkler, *We the Corporations* 70–71 (1st ed. 2018); Pingeot, *supra* note 2, at 5, 27; Knowledge at Wharton Staff, *Co-opting the Constitution: How Corporations Influence American Law*, KNOWLEDGE AT WHARTON (July 2, 2018), <https://knowledge.wharton.upenn.edu/article/co-opting-the-constitution-how-corporations-influenced-american-law/> [<https://perma.cc/CJY6-SAMT>].

<sup>5</sup>See Pingeot, *supra* note 2, at 5.

<sup>6</sup>See Milton Friedman, *A Friedman Doctrine—The Social Responsibility of Business is to Increase Its Profits*, N.Y. TIMES (Sept. 13, 1970), <https://www.nytimes.com/1970/09/13/archives/a-friedman-doctrine-the-social-responsibility-of-business-is-to.html> [<https://perma.cc/JEA8-RMMU>]. Reflecting this popular conception, Professor Lynn Stout observes, “To many people . . . corporations exist to make money for their shareholders. Maximizing shareholder wealth is the corporation’s only true concern, its *raison d’être*. Devoted corporate officers and directors should direct all their efforts toward this goal.” Lynn A. Stout, *Why We Should Stop Teaching Dodge v. Ford*, 3 VA. L. & BUS. REV. 164, 164 (2008).

<sup>7</sup>Milton Friedman advanced the theory of shareholder primacy, the core of which is that the highest purpose of corporations is to maximize profits for their shareholders. Milton Friedman, *Capitalism and Freedom* (2020); see also N. Craig Smith and David Rønnegard, *Shareholder Primacy, Corporate Social Responsibility, and the Role of Business Schools*, 134 J. BUS. ETHICS. 463, 464 (2016) (equating the Friedman doctrine with shareholder primacy).

<sup>8</sup>*Dodge v. Ford Motor Co. (Dodge v. Ford)*, 170 N.W. 668, 684 (Mich. 1919).

decision not to distribute special dividends, so that the company could instead lower the prices of the automobiles it produced and increase employment, would serve the interests of consumers and employees but not the company.<sup>9</sup> The court held the decision violated the director's fiduciary duty owed to the shareholders.<sup>10</sup>

As further discussed in Section 2, the court decision has set shareholder primacy as a legal obligation, not just a business objective, and created a distinction between corporate interests and the interests of other stakeholders such as employees, consumers, and the community at large.<sup>11</sup> This separation has considerable social ramifications because corporate interests and those other interests are closely intertwined: a majority of the population are employees of corporations and meet their economic needs through the goods and services that corporations provide.<sup>12</sup> Considering the extent of corporate influence today, the pursuit of shareholder interests over the interests of other stakeholders can cause considerable adverse effects, such as inattention to social and environmental harms.<sup>13</sup>

The economic, social, and political powers of corporations today are incomparably stronger than those that existed at the time of the *Dodge* decision; thus, the economic and social impact of the decision upholding shareholder primacy would be significant, should the decision have a legal effect.<sup>14</sup> Academic views diverge: some scholars have argued that shareholder primacy is not the law and that the *Dodge* decision

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<sup>9</sup>*Id.*

<sup>10</sup>*Id.*

<sup>11</sup>See discussion *infra* Section 2.

<sup>12</sup>See Blumberg, *supra* note 1 (corporations produce the majority of goods and services to the economy); Palladino, *supra* note 2 (less than 1% of businesses employ over half of employees).

<sup>13</sup>Benedict Sheehy, *Corporations and Social Costs: The Walmart Case Study*, 24 J.L. & COM. 1, 35–48 (2004); Grant Hayden and Matthew Bodie, *What Comes After Shareholder Primacy? Employee Empowerment*, CLS BLUE SKY BLOG (Sept. 16, 2019), <https://clsbluesky.law.columbia.edu/2019/09/16/what-comes-after-shareholder-primacy-employee-empowerment/> [<https://perma.cc/N8V5-9DZG>].

<sup>14</sup>See Pingeot, *supra* note 2, at 5 (discussing how corporations have become more powerful over the past 25 years).

should not be considered relevant to current law,<sup>15</sup> while others are more cautious about refuting its legal status.<sup>16</sup> The author has concluded that it has the legal status in the United States, but regardless of the final determination,<sup>17</sup> lawyers cannot disregard shareholder primacy altogether in the face of shareholder challenges supported by this notion due to the variances in state legislation and the lack of clarity in case law.<sup>18</sup>

Shareholder primacy, whose ultimate goal is to maximize shareholders' interests, has become a corporate norm regardless of its status as the law:<sup>19</sup> shareholders' innate human desires to see their shares of profit maximized—what we call “market forces”—would only be a natural driver of shareholder primacy.<sup>20</sup> In addition to the cited market forces, corporate counsels, who have studied corporations in law school, would have covered *Dodge v. Ford* and would likely advise directors and officials to comply with the requirements of shareholder primacy.<sup>21</sup> The prevalent result from this powerful combination—i.e., recognition of shareholder primacy as a norm and its promotion under market pressure—is corporations' short-term profit seeking.<sup>22</sup> This has significant social ramifications, as the short-term profit seeking would justify behavior that might be contrary to the interests of society, such as cutting wages and customer support, but would improve profits for corporations in the short run.<sup>23</sup> To counter this type of corporate conduct, civil society has been emphasizing corporate social responsibility (CSR), putting corporations under considerable pressure to be more

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<sup>15</sup>See Stout, *supra* note 6 (refuting the legal status of *Dodge v. Ford*).

<sup>16</sup>Jonathan R. Macey, *A Close Read of an Excellent Commentary on Dodge v. Ford*, 3 VA. L. & BUS. REV. 177, 178 (2008).

<sup>17</sup>Yong-Shik Lee, *Reconciling Corporate Interests with Broader Social Interests—Pursuit of Corporate Interests Beyond Shareholder Primacy*, 13 WILLIAM & MARY BUS. L. REV. 1, 24–33 (2022).

<sup>18</sup>*Id.* See also Macey, *supra* note 16, at 179.

<sup>19</sup>See, e.g., Robert J. Rhee, *A Legal Theory of Shareholder Primacy*, 102 MINN. L. REV. 1951, 1953 (2008).

<sup>20</sup>*Id.* at 1952–1953.

<sup>21</sup>Stout, *supra* note 6, at 164.

<sup>22</sup>See Lynn A. Stout, *The Toxic Side Effects of Shareholder Primacy*, 161 U. PA. L. REV. 2003, 2016–2019 (2013).

<sup>23</sup>*Id.* at 2017.

accountable to society,<sup>24</sup> but it is not clear whether these efforts are sufficient to contain the corporate activities adverse to social interests.<sup>25</sup> This monograph analyzes these issues in Section 3.<sup>26</sup>

Corporate interests, and the broader economic interests of society<sup>27</sup> are not mutually exclusive and can be reconciled by allowing corporate directors and managers to define corporate interests beyond shareholder primacy.<sup>28</sup> There is no compelling public policy ground for limiting corporate interests so narrowly; if the controlling majority of shareholders support a board decision to promote broader economic interests in society, perhaps at the expense of maximizing immediate profits, there seems to be no compelling reason for a court to find that such a decision violates the fiduciary duty owed to shareholders.<sup>29</sup>

This approach may also promote corporations' and shareholders' long-term interests; by promoting broader economic interests, corporations may acquire goodwill from the public and reinforce their consumer base, which, in turn, will contribute to their future sales and profits.<sup>30</sup> As the shareholder primacy rule does not require immediate profit maximization but allows measures to increase long-term profits, which may well involve benefits to employees, customers, and the community, the separation between "corporate interests" and "social interests" is rather arbitrary and is subject only to a rhetorical distinction.<sup>31</sup> Shareholder primacy that purports to prioritize shareholders' interests over the interests of other stakeholders, for this reason, is not tenable in practice.<sup>32</sup> Also, shareholder interests are not uniform but varied, and shareholder

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<sup>24</sup>See, e.g., Smith and Rönnegard, *supra* note 7, at 463.

<sup>25</sup>*Id.*

<sup>26</sup>See discussion *infra* Section 3.

<sup>27</sup>The terms, "broader economic interests in society" and "social interests" are used interchangeably throughout this monograph unless indicated otherwise. Also, "shareholder value" and "profit" are used interchangeably without distinction.

<sup>28</sup>Smith and Rönnegard, *supra* note 7, at 464.

<sup>29</sup>*Id.* If and when the majority shareholders do not support such board decisions, they can overturn the decision by changing the leadership of the corporation. Alex Gorman, Note, *Exit vs. Voice: A Comparison of Divestment and Shareholder Engagement*, 72 N.Y.U. ANN. SURV. AM. L. 113, 133 (2017).

<sup>30</sup>See Smith and Rönnegard, *supra* note 7, at 470–471.

<sup>31</sup>See Macey, *supra* note 16, at 190.

<sup>32</sup>See Stout, *supra* note 22, at 2017.

primacy does not answer the question of *which shareholders' interests* should be prioritized.<sup>33</sup>

Corporations should not be compelled to resort to the argument of profit maximization to justify decisions that may appear contrary to shareholder primacy.<sup>34</sup> Dissatisfied shareholders have recourse, including the ability to sell their stocks on the open market or to negotiate with the corporation to buy their stocks on mutually-agreeable terms.<sup>35</sup> This monograph examines the flaws of shareholder primacy as the principle for corporate governance and discuss an alternative approach (the stakeholder approach) in Section 4.<sup>36</sup> It also discusses the necessity of a statutory adjustment and propose legal reform to clarify the current ambiguity about the legal status of shareholder primacy.<sup>37</sup> Section 5 draws conclusions.<sup>38</sup>

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<sup>33</sup>*Id.* at 2016–2017.

<sup>34</sup>See Macey, *supra* note 16, at 190.

<sup>35</sup>Kevin Schott, *Executive Pay Does Not Need Its Day in Court*, 14 Hous. Bus. & Tax L.J. 258, 268 (2014).

<sup>36</sup>See discussion *infra* Section 4.

<sup>37</sup>See discussion *infra* Section 4.

<sup>38</sup>See discussion *infra* Section 5.

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## Conclusion

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Over 100 years have passed since *Dodge v. Ford*, one of the most cited cases in corporation textbooks and literature.<sup>293</sup> Still, controversy about its legal status persists in the United States.<sup>294</sup> Shareholder primacy, the principle of corporate governance upheld by this seminal case, has been accepted by most lawyers, judges, businesspeople, and policymakers as the operative concept for corporate governance in the United States.<sup>295</sup> Shareholder primacy had become prominent by the late 1990s and it has shaped corporate behavior and affected the economy and society in fundamental ways.<sup>296</sup> For example, corporate directors and officers have focused on short-term performance to maximize shareholder value, often at the expense of non-shareholding stakeholders, causing adverse social effects as demonstrated by economic polarization.<sup>297</sup>

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<sup>293</sup>Stout, *supra* note 6, at 166.

<sup>294</sup>Lee, *supra* note 17, Part II.

<sup>295</sup>*Id.*, Section II.C.2.

<sup>296</sup>*Id.*, Section II.A.2.

<sup>297</sup>*Id.*, Section III.C.



Shareholder primacy has legal status, as enunciated by the Chief Justice of the Supreme Court Delaware in his recent writing.<sup>298</sup> However, the rule is largely aspirational and unenforceable.<sup>299</sup> The interests of shareholders are not uniform but varied and, at times, in conflict with each other; thus, directors and officers will have to decide whose interests will be served, and not surprisingly, they tend to prioritize the interests of powerful institutional shareholders with short-term profit goals.<sup>300</sup> It is a myth that shareholder primacy enhances the corporate value: as an empirical study has revealed, it encourages directors and officers to focus on short-term performance at the expense of long-term performance<sup>301</sup> and, in the process, undermines the interests of non-shareholding stakeholders such as employees, customers, and the community.<sup>302</sup>

This monograph proposes law reform in the form of statutory adjustment that specifically authorizes directors and officers to pursue the interests of non-shareholder stakeholders as well as shareholders and clarifies that one interest is not subordinate to another.<sup>303</sup> This is not necessarily an attempt to replace shareholder primacy with other types of corporate governance<sup>304</sup> despite my personal preference for the stakeholder approach—but to allow each corporation to decide their own governance: if they wish to pursue the interests of non-shareholding stakeholders independent of shareholders' interests, they should be free to do so without having to register as SPCs or benefit corporations.

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<sup>298</sup>Leo E. Strine, Jr., *The Dangers of Denial: The Need for a Clear-Eyed Understanding of the Power and Accountability Structure Established by the Delaware General Corporation Law*, U. PA. INST. FOR L. ECON., Research Paper No. 15-08 (2016), <http://ssrn.com/abstract=2576389> [<https://perma.cc/U86H-XJV3>], at 3–4.

<sup>299</sup>Macey, *supra* note 81, at 190.

<sup>300</sup>Stout, *supra* note 22, at 2004.

<sup>301</sup>Barton *et al.*, *supra* note 132, at 1.

<sup>302</sup>See discussion *supra* Section 3.

<sup>303</sup>*Id.*

<sup>304</sup>Lund and Pollman project that shareholder primacy is likely to remain a dominant norm. Dorothy S. Lund and Elizabeth Pollman, *The Corporate Governance Machine*, 121 COLUM. L. REV. 2563, 2630–2631 (2021). They point out that “as the shareholder primacy viewpoint has become enmeshed in our cultural and institutional understanding of good governance and as multiple powerful players operate as gatekeepers for the shareholder primacy norm, it becomes difficult to move to another.” *Id.* at 2630.

Ultimately, corporations will have to comply with the wishes of the majority shareholders—shareholders can remove and replace any director who does not.<sup>305</sup> The question of corporate interests—whether they are primarily shareholders’ interests or broader stakeholders’ interests—must be left to each corporation, not to a court enforcing an alleged legal mandate.<sup>306</sup> The current situation is ambiguous in the United States: many believe shareholder primacy is the law, some do not; some think it is an effective law, and others believe it is just aspirational.<sup>307</sup> This state of confusion has remained unchanged for decades.<sup>308</sup> It is why legislatures, particularly that of Delaware—the most important jurisdiction on corporate affairs—should implement the proposed statutory clarification.<sup>309</sup>

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<sup>305</sup>Smith and Rönnegard, *supra* note 7, at 464.

<sup>306</sup>See, e.g., *Aronson v. Lewis*, 473 A.2d 805, 805 (Del. 1984).

<sup>307</sup>Lee, *supra* note 17, Sections I.A and I.B.

<sup>308</sup>*Id.*, Section I.B.

<sup>309</sup>*Id.*