

Balance and Team Production

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I. INTRODUCTION

For decades, those holding the shareholder primacy view that the purpose of a corporation is to earn a profit for its shareholders have been debating with those who believe that corporations exist to serve broader societal interests.¹ Adolph Berle and Merrick Dodd began the conversation over eighty years ago,² and it continues today, with voices at various places along a spectrum of possible corporate purposes participating. Unfortunately, over time, the various sides of the debate have begun to talk past each other rather than engage with each other and have lost sight of whatever common ground they may be able to find between them.

This Essay shows how the gaps between the two perspectives may be bridged, or how the two camps may be brought closer to engaging in meaningful dialogue, by considering the insights contained in Margaret

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1. See, e.g., Lucian A. Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833 (2005) (arguing that corporate managers are responsible to shareholders and must work to maximize shareholder value); E. Merrick Dodd, Jr., *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145 (1932) (arguing that corporate managers have a responsibility to serve societal interests); Frank H. Easterbrook & Daniel R. Fischel, *The Corporate Contract*, 89 COLUM. L. REV. 1416 (1989) (arguing, contra the “entity” theory, that a corporation is a “nexus” of contracts and not a stand-alone entity, and so corporate managers are simply responsible for abiding by the corporate contracts); David Millon, *Theories of the Corporation*, 1990 DUKE L.J. 201 (1990) (arguing that corporations, as “entities” and “citizens,” should behave as responsible citizens for the benefit of society); Milton Friedman, *The Social Responsibility of Business Is to Increase Its Profits*, N.Y. TIMES MAG., Sept. 13, 1970, at 32, available at <http://www.colorado.edu/studentgroups/libertarians/issues/friedman-soc-resp-business.html> (arguing that corporate managers have a social responsibility to work to maximize shareholder value).

2. See, e.g., Adolf A. Berle, *Corporate Powers As Powers in Trust*, 44 HARV. L. REV. 1049 (1931); Adolf A. Berle, *For Whom Corporate Managers Are Trustees: A Note*, 45 HARV. L. REV. 1365 (1932); Dodd, *supra* note 1.

Blair and Lynn Stout's *A Team Production Theory of Corporate Law*.³ Blair and Stout paint a picture of corporate governance that helps explain why the business judgment rule works as it does and how corporate boards can legally and properly make a variety of decisions in particular situations.⁴ They show how it is permissible for a board to make decisions that appear to place the interests of nonshareholder stakeholders before the immediate interests of shareholders without running afoul of their duties under corporate law.⁵

Though Blair and Stout purport to reject shareholder primacy throughout the article, their insights do not necessarily undermine a realistic shareholder primacy view of corporate governance.⁶ Rather, their description of the board of directors and proper corporate objectives provides a positive account of how directors manage the coalition of interests that make up the corporation.⁷ This account does not render shareholder wealth maximization impossible. To the contrary, it shows how, as with any business decision, there are costs associated with maximizing returns. Encouraging other stakeholders to participate in the corporate enterprise may impose costs on the corporation, but those costs are intended to be outweighed by returns to investors in the form of enhanced shareholder wealth.⁸ Viewed in this light, Blair and Stout's team production model fits well with the economic account of the modern corporation.

The traditional economic account of the corporation supposes that shareholders are the effective owners of the firm, while directors—essentially the agents of the shareholders—are charged with maximizing corporate wealth for the benefit of the residual claim.⁹ Shareholders are usually the residual claimants; however, as a firm becomes insolvent and creditors take over the residual claim, the duty to maximize corporate wealth inures to the creditors' benefit.¹⁰ The residual claimants have incentives that are best aligned with those of the corporate entity such that

3. Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247 (1999).

4. *See generally id.*

5. *Id.* at 307.

6. *Id.* at 257.

7. *Id.* at 280–81.

8. *Id.* at 288–89.

9. Alan J. Meese, *The Team Production Theory of Corporate Law: A Critical Assessment*, 43 WM. & MARY L. REV. 1629, 1631 (2002).

10. *See* Barry E. Adler, *Financial and Political Theories of American Corporate Bankruptcy*, 45 STAN. L. REV. 311, 313 (1993).

one could assume that what is best for the residual claim is best for the corporation as a whole.

On the other hand, those who reject shareholder primacy, including Blair and Stout, argue that directors are given great autonomy to choose to prefer the interests of a variety of stakeholders depending on the circumstances.¹¹ They argue that shareholder interests will not always yield the best corporate outcomes and that boards should be, and are, free to prefer other interests in order to maximize the value of the corporate enterprise as a whole.¹² Likewise, they argue that if we can understand directors as something other than the shareholders' agents, then not only will we have reached a more accurate understanding of corporate governance, but embracing that view will lead to better governance decisions as directors will feel completely liberated to make the "right" choices.¹³

In this Essay, I will bring these competing ideas together and show how they are compatible within one description of modern corporate governance. As Blair and Stout point out, balance is the key to harmonizing conflicting views of directors' duties.¹⁴ However, finding balance does not come at the expense of maximizing the value of the residual claim. For example, a corporation that takes extraordinary risks on a regular basis may find it difficult to borrow money or find business partners willing to extend credit, and may also have trouble retaining competent employees. On the other hand, a firm that stagnates for having taken minimal risk and having been operated for the benefit of creditors and employees may eventually fail, harming the very parties whose interests it was trying to protect.¹⁵ Corporate governance, in all of its forms, seeks to balance the interests of constituent parties and management *in order to maximize the value of the residual claim*. While managerial fiat exercised to other ends may not be easily punished under the law,¹⁶ it is not rewarded either, and such managers or directors may find themselves without further employment or find that their value on the market is diminished.

11. Blair & Stout, *supra* note 3, at 280.

12. *Id.* at 280–81 (“Thus, the primary job of directors of a public corporation is not to act as agents who ruthlessly pursue shareholders’ interests at the expense of employees, creditors, or other team members. Rather, the directors are trustees for the corporation itself—mediating hierarchs whose job is to balance team members’ competing interests in a fashion that keeps everyone happy enough that the productive coalition stays together.”).

13. *Id.*

14. *Id.* at 316.

15. The management of General Motors, which purportedly ran the company for the benefit of trade unions and creditors in the 1990s and 2000s, provides such an example. See *infra* notes 98–105 and accompanying text.

16. Blair & Stout, *supra* note 3, at 294.

This Essay proceeds in four parts. Part II begins by reviewing the relevant portions of the debate between “shareholder primacists” and those who believe that directors should make decisions that serve other stakeholders to the exclusion of shareholder interests. Blair and Stout position themselves somewhat in the middle of these two positions while maintaining that shareholder primacy is not a viable positive or normative theory.¹⁷ Because Blair and Stout’s claim is a moderate position, their work can serve as an effective gateway between the two sides. Part III cultivates an understanding of shareholder primacy that demonstrates that such a view is not necessarily incompatible with the corporate wealth maximization sought by Blair and Stout. Part IV considers what Blair and Stout mean by “balance” in corporate governance and shows how that balance can be a means to shareholder primacy ends. Part V briefly concludes.

II. THE DEBATE

The debate between those who believe a corporation’s purpose is maximizing profit and those who believe corporations exist for the greater social good has raged for decades. Adolph Berle and Merrick Dodd managed to truly engage with one another and make progress in reaching a greater understanding of the other’s position, with Berle eventually adopting Dodd’s position decades after their debate began.¹⁸ More recently, modern scholars on opposite sides of the debate have all but stopped talking to each other. Instead, each side is so entrenched in its own position and believes the other to be completely, ideologically wrong that any sort of dialogue or compromise seems impossible.

The shareholder primacy view of corporate law holds that corporations exist to generate profits for their owners, the shareholders.¹⁹ As such, when there is a choice between lowering costs or improving social conditions that will not enhance profits, a shareholder primacist would choose to lower costs in the interest of increasing profits. Where the interests of the community, employees, creditors, or the environment conflict with the goal of increasing profits, pure shareholder primacists would argue that directors must choose the path that favors profit maximization.²⁰

17. *Id.* at 253–54.

18. William W. Bratton & Michael L. Wachter, *Shareholder Primacy’s Corporatist Origins: Adolf Berle and the Modern Corporation*, 34 J. CORP. L. 99, 104 (2008).

19. Blair & Stout, *supra* note 3, at 287.

20. *See* Friedman, *supra* note 1.

Corporate social responsibility advocates, whom Blair and Stout call “progressives,” on the other hand, argue that corporations owe a duty to society to make business decisions that will advance the interests of corporate constituents other than shareholders, such as employees and the surrounding communities.²¹ The corporation can advance these constituents’ interests by providing fair working conditions, charging reasonable prices, and taking steps to preserve the environment at the expense of profit.²² Because their premises differ so substantially, shareholder primacists and progressives rarely find common ground.

Blair and Stout have positioned themselves between the two extremes, arguing that directors are mediating hierarchs that serve the interests of all corporate stakeholders, not just shareholders.²³ While the pursuit of profit may be a worthwhile goal, Blair and Stout suggest it is not the only permissible object of a board’s decision-making authority.²⁴ Furthermore, Blair and Stout argue that the team production theory, as they apply it to corporate governance, explains why directors have discretion to consider other interests, and that this discretion is the sort of *ex ante* understanding that allows the firm to exist and prosper in the first place.²⁵

This Part of the Essay will introduce the shareholder primacy argument and contrast it with the view of corporate governance developed by Blair and Stout in *A Team Production Theory of Corporate Law*. The precise contours of the debate between shareholder primacists and those advancing corporate social responsibility are beyond the scope of this Essay. For our purposes, it is only important to acknowledge where the two poles are and to see how Blair and Stout’s work can show us how to tell a consistent story about directors’ duties and corporate purpose.

A. Shareholder Primacy—Basic Argument

The shareholder primacy view, as Blair and Stout call it, is the traditional economic agency view of corporate governance. As traditionally presented, the theory holds that shareholders are the owners of a corporation, and they hire directors to manage the business and affairs of the

21. Blair & Stout, *supra* note 3, at 287.

22. See, e.g., Dodd, *supra* note 1; Millon, *supra* note 1; David Millon, *Redefining Corporate Law*, 24 IND. L. REV. 223 (1991); Lawrence E. Mitchell, *A Critical Look at Corporate Governance*, 45 VAND. L. REV. 1263 (1992).

23. Blair & Stout, *supra* note 3, at 287–89.

24. Indeed, as the authors observe, “modern corporate law does not adhere to the norm of shareholder primacy. To the contrary, case law interpreting the business judgment rule often explicitly authorizes directors to sacrifice shareholders’ interests to protect other constituencies.” *Id.* at 303.

25. *Id.* at 287–89.

corporation on their behalf.²⁶ Shareholders vote to elect directors for this purpose, and those directors, in turn, choose and monitor senior officers who will run the day-to-day business of the firm. The purpose of a corporation under this view is to maximize profit for the benefit of shareholders.

The traditional view has matured over the course of time. Shareholders remain the putative owners of the firm, but only because of their role as residual claimants when the firm is solvent. In this regard, options theory holds that all claimants on the firm's assets hold options in the value of those assets.²⁷ Shareholders do not hold a special position as "owners" according to that account. Instead, depending on one's perspective, shareholders can hold one of two kinds of options in the firm's assets. Shareholders can be seen as holding a call option on the residual claim that they can exercise by paying off debt when the firm is solvent.²⁸ Conversely, when a firm is insolvent, shareholders can exercise a put option and sell the firm's assets to creditors for the value of the firm's debt.²⁹

Options theory maps onto the traditional account by highlighting the shifting interests in the firm's assets, depending on the firm's financial stability. When a firm is insolvent, its junior-most creditors hold claims that may be paid something, rather than nothing, and now occupy the role of residual claimants. Shareholders will have exercised their put option, and creditors now occupy the position of wanting to enhance the value of the firm's assets for their own benefit. Those who favor shareholder primacy when a firm is solvent, then, will also argue that the firm should be operated for the benefit of creditors in bankruptcy because junior creditors then hold the residual claim.³⁰ The residual claim is favored because it best represents the value of corporate wealth, and thus, the value of corporate well-being. What is good for the value of the residual claim should be good for the viability of the company, and thus, good for all those holding claims against the corporation's assets, including employees, shareholders, and creditors.

26. Meese, *supra* note 9, at 1631.

27. Frank Partnoy, *Adding Derivatives to the Corporate Law Mix*, 34 GA. L. REV. 599, 609–12 (2000) (explaining the application of options theory to corporate governance).

28. *Id.* at 609–10 (describing the call option perspective).

29. *Id.* at 610–11 (explaining the put option perspective wherein equity has sold a put option to debt, allowing equity to sell the firm to debt if the value of the firm's assets falls below the amount of debt).

30. *See* Adler, *supra* note 10 (arguing that the residual claimants may change during the life of the firm, but current residual claimants should always have the most power to influence management).

The shareholder primacy economic model's depiction of directors as literal "agents" of shareholders has also been relaxed. It is generally understood that directors owe no duty of obedience to shareholders.³¹ If there were a duty of obedience, which shareholders would the directors be bound to obey? Shareholders may have divergent or even conflicting interests. Additionally, what would the mechanism of that control be? The business judgment rule protects directors from liability to shareholders for failure to obey, among other things, and shareholder voting is unlikely to be an effective mechanism to enforce the will of shareholders on directors' decision making. Shareholders are not able to vote on specific day-to-day business decisions and may only approve or disapprove significant, game-changing decisions such as mergers and electing directors.

Even though directors are not literally subject to direct control by shareholders, and so may not technically be considered agents of shareholders (or any other identifiable group with a distinct voice), they still present agency costs. Directors impose agency costs because they are managing assets that do not belong to them in order to realize profits for others. Directors have incentives to shirk and self-deal in ways that could harm the financial interests of others, and directors do not internalize all of the costs of their behavior. Directors are working on behalf of others, even if they are not bound to obey those others, and those others lack legal recourse in many instances where directors may disappoint their hopes or expectations. Because we expect directors to act for the benefit of others, and not for themselves, the law and private contracting must try to design incentives that prevent directors from self-dealing or using their power to harm those they are charged with helping. Those working within the standard economic paradigm look for ways to minimize the agency costs imposed by corporate directors. Those agency costs are defined as incentives directors may have to appropriate corporate wealth to themselves.

The agency costs posed by directors and the entity for which they work are central to the disagreement between shareholder primacists and those in favor of corporate social responsibility. Shareholder primacists think that agency costs should be limited so that the value of the residual claim is increased.³² They argue that the divergence between directors'

31. The business judgment rule and the cases interpreting it make clear that directors are under no obligation to make the business decisions shareholders would necessarily want them to make. Directors are not subject to liability provided they exercise good faith and informed judgment that they honestly believe to be in the best interest of the corporation. Blair & Stout, *supra* note 3, at 299–300.

32. Bebchuk, *supra* note 1, at 850.

personal interests and shareholders' economic interests should be minimized and that directors should be held accountable to maximizing shareholder wealth.³³ Maximizing the value of the residual claim, they argue, will maximize the value of the corporation, and that rising tide of corporate profits will raise all ships, from shareholders to directors.³⁴

B. Blair and Stout—Team Production

On the other hand, those advocating corporate social responsibility think that directors have a duty (or should have a duty) to consider a variety of constituencies in making corporate decisions.³⁵ Because directors are the leaders of a social enterprise and corporations must be responsible citizens of our world,³⁶ they must work for some greater, less-defined social good. They have some other “corporate” and societal benefit to seek. Those advocating this belief, “progressives” as Blair and Stout call them, would put societal interests ahead of corporate wealth maximization.³⁷

While Blair and Stout do not subscribe to the “progressive” corporate social responsibility view, they do argue that the corporation should not be run solely for the benefit of shareholders.³⁸ They see the corporation as a combination of inputs from various team members.³⁹ These team members then delegate control over coordination of their inputs to a board of directors.⁴⁰ Accordingly, Blair and Stout argue that the board does not owe allegiance to any one stakeholder, but rather, is empowered to do what is “best” for the corporate enterprise.⁴¹ The board should honor the interests of all team members as necessary to maximize the welfare of the entire enterprise.

In developing their theory, Blair and Stout draw on the Alchian and Demsetz notion of team production to make their point about how corporate governance operates.⁴² In a team production situation, a number of team members contribute inputs, but the product of the team's efforts

33. *Id.*

34. *Id.*

35. Colin P. Marks, *Jiminy Cricket for the Corporation: Understanding Corporate “Conscience”*, 42 VAL. U. L. REV. 1129, 1148 (2008).

36. *See id.*

37. Blair & Stout, *supra* note 3, at 287.

38. *Id.* at 254.

39. *Id.* at 275.

40. *Id.* at 277.

41. *Id.* at 254.

42. *Id.* at 265 (citing Armen A. Alchian & Harold Demsetz, *Production, Information Costs, and Economic Organization*, 62 AM. ECON. REV. 777 (1972)).

cannot be separated and directly linked to their individual efforts.⁴³ As a result, it is impossible to know exactly what proportion of the final product each individual team member is responsible for.⁴⁴ According to Alchian and Demsetz's theory, in such situations, when it is difficult to distribute profits among team members in the face of necessarily incomplete contracts, a third party is given responsibility to monitor the team and distribute the proceeds of the team's effort at fixed wages.⁴⁵ Then the monitor—the hierarch—receives the residual returns. This would give the hierarch the incentive to maximize the value of the team.⁴⁶ Blair and Stout adjust this model to claim that the board of directors is the monitoring hierarch but that the corporation itself receives the residual returns on the team's labor.⁴⁷

In its role as “mediating hierarch,” the board is supposed to use its discretion to make the decisions it believes are best for the corporate enterprise, even if those decisions are not the ones shareholders would prefer or are not strictly best for maximizing shareholders' risk-adjusted wealth.⁴⁸ Shareholders can diversify away firm-specific risk in a way that employees and managers cannot. Creditors can price in the riskiness of the investment by charging higher interest rates and then can negotiate covenants that allow them to directly control the risks the company takes when the firm reaches an agreed-upon level of financial difficulty. When facing a decision with uncertain outcomes, various corporate constituents will have different preferences because they have different appetites for risk. Thus, potentially more profitable decisions that carry a higher risk of failure will not be as appealing to creditors or employees as they are to shareholders. As Blair and Stout point out, the board has the authority to choose the option that maximizes the expected return to the corporate enterprise from a risk-neutral standpoint, rather than pursuing the course of action shareholders would prefer.⁴⁹

There are, of course, many ways the shareholders' preferences could differ from those of other corporate constituents. For example, taking into account only wealth-maximizing preferences, shareholders might prefer to cut costs by closing business locations or laying off

43. *Id.* at 265–66.

44. Armen A. Alchian & Harold Demsetz, *Production, Information Costs, and Economic Organization*, 62 AM. ECON. REV. 777, 777–78 (1972).

45. *Id.* at 782.

46. Blair & Stout, *supra* note 3, at 266.

47. *Id.* at 269.

48. *Id.* at 280.

49. *Id.* at 295–96 (citing *Credit Lyonnais Bank Nederland, N.V. v. Pathe Commc'ns Corp.*, Civ. A. No. 12150, 1991 WL 277613 (Del. Ch. Dec. 30, 1991)).

workers. Maximizing shareholder wealth might also mean making a decision to conduct business in a manner that poses risks to the environment or lowers the value of surrounding property. Blair and Stout would argue that boards do not have to make these trade-offs if they believe they are acting in the corporation's best interests.⁵⁰ Accordingly, Blair and Stout note that the interests of the corporation need not be measured by the "bottom line" of the value of the residual claim.⁵¹

In addition to their focus on corporate welfare as a whole, Blair and Stout strongly reject shareholder primacy. They point out that, as a positive matter, shareholder primacy is not legally required—nothing in corporate law requires directors to favor shareholder interests, and directors are not held liable for favoring the interests of other stakeholders.⁵² They also make the normative claim that making shareholder wealth maximization the primary concern of corporate decision making is bad for the corporation itself, society, and even for shareholders in the long run.⁵³

That begs the question of how we measure the "interests of the corporation" and then balance those interests against shareholder wealth maximization. How do we know that something is good for the corporation even though it may not enhance corporate wealth? Alchian and Demsetz spoke in terms of maximizing the wealth generated by the team.⁵⁴ Blair and Stout also concede that the value of a company's stock is often a useful tool for determining the value of the corporate enterprise as a whole, and that even if shareholders are not the residual claimants, that the residual claim is a useful proxy for corporate value.⁵⁵ A corporate decision may be beneficial to employees or the community or suppliers, but how can we tell if it is also good for the corporation? How will we know when those interests are properly balanced without regard to corporate wealth, as measured by the value of the residual claim? How literally should we take the agency analogy of shareholder primacy, how literally should we take the depiction of board fiat and authority in Blair and Stout's team production theory, and how can we reconcile the theories?

Part III will consider the different understandings of shareholder primacy that persist in the debate about the appropriate role of shareholder interests in corporate governance. The analysis will reveal that a

50. *Id.* at 300–01.

51. *Id.*

52. *Id.* at 288–89.

53. *Id.* at 305.

54. Alchian & Demsetz, *supra* note 44, at 778.

55. Blair & Stout, *supra* note 3, at 289.

balanced, moderate understanding of shareholder primacy is perfectly consistent with Blair and Stout's theory of team production in corporate governance. Additionally, the analysis will show that Blair and Stout do not need to maintain that shareholder interests are irrelevant to corporate decision making, or even that shareholder interests should be resisted. Rather, a correct understanding of shareholder primacy leads to the conclusion that the interests of corporate constituents need to be balanced in order to maximize shareholder wealth.

III. THE DIFFERENT FACES OF SHAREHOLDER PRIMACY

David Millon has defined the shareholder primacy norm as "mandat[ing] that management—the corporation's directors and senior officers—devote its energies to the advancement of shareholder interests. If pursuit of this objective conflicts with the interests of one or more of the corporation's nonshareholder constituencies, management is to disregard such competing considerations."⁵⁶ Though shareholder primacy may sound simple, it has proven to be an elusive concept. The command to maximize the value of a corporation's equity, as measured by stock price, seems like it would be one that is capable of precise definition and measurement. It surely seems that one could consider a set of outcomes, calculate their expected values for shareholders, and choose the course of action that has the highest expected value for the equity position. Of course, it is not that easy. For example, the likelihood that a particular outcome will occur is uncertain, as are the values of those outcomes; similarly, shareholders' risk preferences and investment time horizons vary and are also uncertain. Directors and officers simply do not have enough information to just "do the math" and choose the wealth-maximizing course of action.

Even if corporate executives did have all of the information they would need to choose the decision whose outcome has the highest expected value for shareholders, differing risk preferences may make that the wrong choice for enhancing the value of the residual claim, if shareholders are no longer the residual claimants. Further, if all public companies were to make decisions with too great of an appetite for risk, that may compromise corporate value, and so portfolio value, for even well-diversified shareholders. If all shareholder primacy tells us is to make decisions that will maximize the expected value of shareholders, then it

56. D. Gordon Smith, *The Shareholder Primacy Norm*, 23 J. CORP. L. 277, 282 (1998) (citing David Millon, *Communitarianism in Corporate Law: Foundations and Law Reform Strategies*, in PROGRESSIVE CORPORATE LAW 1 (Lawrence E. Mitchell ed., 1995)).

does not tell us anything useful. To define shareholder primacy in such limited terms is to set up a straw man.

This Part will provide a definition of shareholder primacy that will show that maximizing shareholder value does not conflict with a team production view of corporate governance. While any precise definition of shareholder primacy is subject to debate, I will argue that a nuanced understanding of shareholder wealth maximization is the key to sustained growth and profitability, and, therefore, promotes shareholder interests. Holding that interest as a guiding principle in corporate decision making allows corporate executives to manage the firm most efficiently for its investors, constituents, and society.

A. Strict Shareholder Wealth Maximization

An account of shareholder primacy that requires directors to make decisions that provide the greatest expected value to shareholders is the view most vilified by the theory's opponents.⁵⁷ What I call strict shareholder primacy would require considering only return to shareholders when making decisions, maximizing that return assuming full diversification, and so making decisions consistent with a nearly unlimited appetite for risk. In other words, directors would seek to maximize a firm's stock price at each moment. Under a strict shareholder primacy view, managers would always seek to preserve shareholder power throughout the corporation's life cycle, would negotiate deals with other constituents so as to lower all costs, thereby enhancing shareholder profit, and would always resolve difficult decisions in favor of immediate shareholder wealth.

Moreover, strict shareholder primacy would require not just operating the business for a profit, but seeking to mathematically optimize that profit at every opportunity. Followed to its logical conclusion, that requirement would indeed be troubling. Not only is it often impossible to know in advance which course of action would maximize expected return on the corporation's stock price on a given day, but decisions made in favor of short-term profits may compromise long-term goals and viability.⁵⁸ Shareholders within the same corporation may have different

57. Including corporate social responsibility theorists, movies, and all others opposed to shareholder primacy. See Marks, *supra* note 35, at 1148; Larry E. Ribstein, *Wall Street and Vine: Hollywood's View of Business* (Univ. of Ill. Law & Econ., Research Paper No. LE05-010, 2009), available at <http://ssrn.com/abstract=563181>.

58. Mark Roe, *Corporate Short-Termism—In the Boardroom and in the Courtroom*, 68 BUS. LAW. 977, 978–79 (2013).

time horizons for their investments and so would have different preferences for the firm's business activities.⁵⁹

One of the more strenuous objections to shareholder primacy is the claim that it promotes "short-termism," the tendency of managers to seek short-term profits at the expense of long-term growth and profitability in order to please today's shareholders and thereby raise stock prices.⁶⁰ Critics of shareholder primacy argue that short-termism is exacerbated by incentive compensation that focuses on quarterly (so, short-term) earnings and profits, as well as the company's share price within particular windows.⁶¹ A manager so incentivized will want to produce good numbers in the short term in order to boost her compensation. A CEO with an average tenure of seven years may well have moved on by the time the long-term consequences of her short-termist decisions are realized.⁶² Short-termism does not only afflict officers who may be driven by their compensation packages. Directors may also make decisions in favor of short-term results at the expense of long-term interests if influenced by powerful shareholders, such as hedge funds, who have short-term investment horizons.⁶³

There is little argument about whether short-termism would be a bad thing; the consensus is that it would be.⁶⁴ Rather, the debate about short-termism centers on whether it is a decision-making flaw that managers are actually vulnerable to. Some argue that the existence of short-termism depends on a market imperfection that critics of shareholder primacy have yet to show.⁶⁵ That is, if stock prices are meant to be the present discounted value of the corporation's future income stream—and they are—then a realization that long-term value has been compromised would result in a lower stock price today or would encourage more firms to invest in long-run interests in order to take advantage of the foregone

59. *Id.* at 981.

60. See generally LYNN STOUT, THE SHAREHOLDER VALUE MYTH: HOW PUTTING SHAREHOLDERS FIRST HARMS INVESTORS, CORPORATIONS, AND THE PUBLIC 63–73 (2012); Lynne Dallas, *Short-Termism, The Financial Crisis, and Corporate Governance*, 37 J. CORP. L. 265, 268 (2012).

61. STOUT, *supra* note 60, at 63–73.

62. Roe, *supra* note 58, at 980.

63. See Interview by David Bradley with Indra K. Nooyi, CEO, PepsiCo, in Aspen, Co. (June 30, 2014), summarized in Conor Friedersdorf, *Why PepsiCo CEO Indra K. Nooyi Can't Have it All*, THE ATLANTIC (July 1, 2014) [hereinafter Indra K. Nooyi Interview], <http://www.theatlantic.com/business/archive/2014/07/why-pepsico-ceo-indra-k-nooyi-cant-have-it-all/373750/>.

64. See Roe, *supra* note 58, at 981–83 (noting "pernicious" effects of short-termism and citing numerous scholars who have outlined the problem).

65. *Id.* at 987–89.

long-term profits.⁶⁶ In short, the imperfection would be competed away.⁶⁷ Therefore, if shareholders are aware that a firm has traded short-term gains for long-term viability, they should lower their estimation of the firm's future income stream and thus lower the price they are willing to pay for the stock. Shareholders may not be able to make that adjustment without sufficient information or may not understand at the time a decision is made that that is what has happened. But if short-termism is a systemic problem and a common way to run a corporation, as the opponents of shareholder primacy allege, then the market would adjust for the harm that practice causes.

Of course, shareholders with short investment horizons may not care that a firm's future prospects are slim. They may take advantage of a boost to the company's stock price from one day's good news and then sell the stock quickly, before the long-term bad news is apparent. If enough investors behave this way or trade at prices influenced by short-term traders, then the ill effects of the short-term interests may be felt more broadly. Mark Roe refers to this as a "high-velocity trading fringe" that has distorted our impression of the dominant trading strategies in the market.⁶⁸

Other investors, such as hedge funds, may try to influence corporate decision making and then sell stock quickly to realize profits from the corporate policies they recommended.⁶⁹ The amount of influence such shareholders have, then, will be relevant to whether managers make trade-offs in favor of short-term returns in the name of serving shareholder interests. The degree of that influence is subject to debate. Lucian Bebchuk and Mark Roe assert separately that insulating boards from shareholders will not prevent short-termism and may well compromise long-term corporate value.⁷⁰ Roe offers empirical evidence that suggests that the market as a whole may overvalue long-term returns,⁷¹ which, he argues, shows that "the market is not uniformly short term."⁷² Bebchuk offers evidence that even hedge fund intervention, with a relatively short

66. See Lucian A. Bebchuk, *The Myth that Insulating Boards Serves Long-Term Value*, 113 COLUM. L. REV. 1637, 1642–43 (2013) (arguing that short-term interests do not necessarily affect board decision making so as to compromise long-term value); Roe, *supra* note 58, at 981–83.

67. Roe, *supra* note 58, at 981–83.

68. *Id.* at 977.

69. Dallas, *supra* note 60, at 294–95.

70. Bebchuk, *supra* note 66, at 1638; Roe, *supra* note 58, at 980.

71. Roe, *supra* note 58, at 980.

72. *Id.*

time horizon, can result in long-term benefits to a company's performance.⁷³

It is not clear, then, that abiding by shareholder wishes necessarily means seeking short-term returns at the expense of long-term viability. The strict understanding of shareholder primacy may not even accurately describe what shareholders want. Concerns that strict shareholder primacy may lead to short-termism may be misplaced if shareholders are aware, as they seem to be, that short-termism does not benefit shareholder value.

Strict shareholder primacy is not only an impossible goal but one that few, if any, expect to see guiding corporate decision making.⁷⁴ The strict view is a "caricature" that even supporters of shareholder primacy find inaccurately describes their position.⁷⁵ To the extent those opposed to shareholder primacy argue that shareholder primacy means giving into shareholder desires to realize immediate returns at the expense of the longer-term survival of the firm, they mischaracterize the position of those they oppose.

B. The Softer Side of Shareholder Primacy: The Shareholder Primacy Norm

Most shareholder primacists would agree that managers must seek to maximize profit, but within constraints such as abiding by applicable regulations, labor market conditions, creditor demands, customer relations, and, indeed, the dictates of their own consciences.⁷⁶ As Blair and Stout note, the corporate constituents that come together to form the corporation and give it life will not agree to do business with the firm if they are not granted concessions that make investment in the firm attractive.⁷⁷

73. Bebchuk, *supra* note 66, at 1671–73.

74. See, e.g., Stephen Bainbridge, *In Defense of the Shareholder Wealth Maximization Norm: A Reply to Professor Green*, 50 WASH. & LEE L. REV. 1423, 1439 (1993) (“[N]o one other than the occasional law or economics professor seriously expects managers to leave their ethical and moral concerns at home.”).

75. Jonathan Macey, *Sublime Myths: An Essay in Honor of the Shareholder Value Myth and the Tooth Fairy*, 91 TEX. L. REV. 911, 913 (2013). In reviewing Lynn Stout's book, *The Shareholder Value Myth: How Putting Shareholders First Harms Investors, Corporations, and the Public* (STOUT, *supra* note 60), Macey distills Stout's definition of shareholder primacy as, “the notion that executives and senior managers must and should run their companies with the narrow, single-minded purpose of maximizing shareholder value at the expense of all other values.” *Id.* He goes on to say that he does not believe that anyone, even those who have written in support of shareholder primacy, would agree that that is how corporations should be run. *Id.*

76. See *supra* note 74.

77. Blair & Stout, *supra* note 3, at 315 (“To keep their jobs, directors must meet at least the minimum demands of all of the corporations' important constituencies. Otherwise some will leave, and the coalition will fall apart.”).

Sometimes, in order to convince an investor to participate, managers will have to concede power to that investor in certain situations—power that may, at times, trump even the power shareholders can exercise over management. This power would lead managers to decide in the nonshareholder investor's favor should the special circumstances arise.

A manager's ability to absolutely maximize shareholder wealth is limited in many ways. The next section considers those limitations and develops a more realistic, workable view of shareholder primacy. This approach still makes maximization of the residual claim paramount in corporate decision making, but acknowledges the limitations imposed on that quest.

When we allow for a more moderate, realistic view of shareholder primacy, it does not seem to be at odds with the team production theory at all. Indeed, the two theories of governance fit together seamlessly. To find the connection, however, we must first understand shareholder primacy as a norm that guides corporate executives' decision making. It means, at its core, that directors and officers should seek to operate the firm profitably by maximizing the value of the residual claim *within applicable constraints*. Not only is profit maximization not an absolute command, but it is impossible to achieve, as mentioned above.

1. Residual Claim Primacy

The equity interest, or the residual claim, is commonly considered the rising tide that raises all ships. If the residual claim grows, then all other claimants are paid in full, the firm is strong and healthy, and it will continue to operate and maybe even grow. In this regard, Blair and Stout acknowledge that the value of the residual claim is a useful proxy for corporate wealth. One challenge they mount against shareholder primacy is that the shareholder position does not represent the residual claim when the firm is insolvent.⁷⁸ This excellent point is consistent with the justifications for shareholder primacy—the residual claim best represents corporate wealth, and maximizing that interest is the best way we can think of to be sure we are maximizing corporate wealth.

The shareholder primacy norm is more properly stated as a “residual claim primacy” norm. Both shareholder primacy and residual claim primacy rely on the same premise: that the holder of the residual claim has the financial incentive to promote corporate profitability and welfare. Both goals call on the corporation to take profitable risks to enhance the

78. Blair & Stout, *supra* note 3, at 297.

expected return of the residual claim but also realize the residual claimants will receive nothing (which is not their goal) if the firm fails.

When the holders of the residual claim shift, so should the powers that attend it. For example, when a corporation is healthy, corporate law gives shareholders certain powers to influence directors and to enforce the corporate interest. However, when a firm is insolvent, it commonly enters bankruptcy (and may be forced into bankruptcy by creditors who believe that is where they will be best protected); the bankruptcy system places power in the hands of the creditors, now the residual claimants, to influence corporate decision making. Bankruptcy estates are operated for the benefit of creditors, and those managing bankrupt estates are bound to do so in a manner that maximizes creditor recovery to the greatest extent possible.⁷⁹

The problem Blair and Stout point to in making their argument about the shifting residual claim is an important one to address. Citing the famous footnote in the *Credit Lyonnais* decision,⁸⁰ Blair and Stout argue that there are times when the expected value of a given course of action for shareholders gives them incentives to take large risks because they have nothing to lose and everything to gain when the firm is insolvent. Such risks could compromise the continued existence of the firm and sacrifice funds that would have been able to repay those with fixed claims.

Furthermore, tensions always exist between the risk preferences of diversified shareholders and those of fixed claimants. As a result, shareholders who have diversified away firm-specific risk are able to absorb losses suffered by one firm better than employees or suppliers can, and even better than some other creditors. They would rather take big risks to realize big rewards, while others may prefer that the firm be run more conservatively.

However, that does not mean that shareholders, even well-diversified shareholders, have an unlimited appetite for risk. As mentioned above, they would rather the residual claim, and so their interest in the firm, have some value rather than none. Further, while such shareholders are protected from firm-specific risk imposed by any one company, if every company were operated as though shareholders only craved extreme degrees of risk, the portfolio may suffer enough losses that

79. See Michelle M. Harner, *The Search for an Unbiased Fiduciary in Corporate Reorganizations*, 86 NOTRE DAME L. REV. 469, 485–86 (2011).

80. Blair & Stout, *supra* note 3, at 296 (citing *Credit Lyonnais Bank Nederland, N.V. v. Pathe Commc'ns Corp.*, Civ. A. No. 12150, 1991 WL 277613 (Del. Ch. Dec. 30, 1991)).

shareholders would no longer be well-protected.⁸¹ Indeed, conflicting risk preferences may even exist among different shareholders in the same corporation. Some shareholders may be better diversified than others, or they may have hedging investments that allow them to profit from a loss to another investment. Still, other shareholders may be invested in the firm's competitors, or they may be employees of the company and hold their interests as employees paramount to their interests as shareholders.

With all of the different risk preferences and interests shareholders themselves can have, and the different risk preferences and interests corporate constituents can have, there is no one formula that will allow directors to always make the decision that is most consistent with "residual claim primacy." When the path to wealth maximization is uncertain, directors are free to exercise their judgment and choose the course of action they believe is best for the firm, and the business judgment rule shields them from liability for doing so.⁸² Balance is crucial—unlimited risk-taking would not be wise and would cause too many promising firms to fail, while operating a firm too conservatively could cause it to stagnate and keep it from profiting to the full extent of its potential, to the detriment of all of its constituents. What guidance do we give corporate managers? We tell them to do their best to maximize profits (the residual claim) within apposite constraints. Which managers are deemed the most successful and are rewarded for doing a great job? Not the ones that run unprofitable corporations. Thus, managers who ignore the value of the residual claim and run the corporation to other ends do so at their careers' peril.

2. Useful Proxy, Essential Guidance

If residual claim primacy (within given constraints) is an acceptable understanding of shareholder primacy, then Blair and Stout's objections to shareholder primacy unravel, and it becomes easier to see how shareholder primacy fits within the mediating hierarchy theory of the board. However, Blair and Stout do acknowledge that shareholders "often are in the best position to represent the interests of the coalition that represents the firm."⁸³ They go on to say that it is appropriate for the shareholders'

81. In summarizing arguments made by another scholar, Stephen Bainbridge writes, "In other words, taking the argument to its logical extreme, it is acceptable to wipe out the entire shareholder value of a particular firm because only part of the shareholders' portfolio will be lost. (But what happens if all firms follow Green's prescription?)" Bainbridge, *supra* note 74, at 1433.

82. This is the central thesis of the point Chancellor Allen makes in the *Credit Lyonnais* decision. *Credit Lyonnais Bank Nederland, N.V. v. Pathe Commc'ns Corp.*, Civ. A. No. 12150, 1991 WL 277613 (Del. Ch. Dec. 30, 1991).

83. Blair & Stout, *supra* note 3, at 289.

enforcement rights to shift to creditors when a firm is insolvent because at the point of insolvency, creditors are in the best position to represent the interests of the corporate coalition.⁸⁴ So in most instances, and in all of the specific instances Blair and Stout point to, those whose financial interests are directly aligned with the value of the residual claim are most qualified to represent the corporate coalition. Pursuing the residual claim tends to maximize profit to the extent it is reasonable, legal, and sensible.

Not only do Blair and Stout acknowledge that the value of the residual claim is often the best proxy for the well-being of the corporation as a whole, but they also do not give any other metrics we can use to determine corporate well-being. And none come to mind. Corporate managers could decide to make a decision that makes employees happy, for example by raising wages, but how do we tell if that decision is good for the corporation or just good for employees? We may never know how much the decision helps or hurts the firm's profitability. But that uncertainty does not change the fact that the corporation's economic well-being, as measured by the value of the residual claim, is the most reliable metric we have for corporate welfare.

Measuring the value of the residual claim can be complicated, particularly for a healthy firm. Stout has pointed out that different shareholders may have different valuations of a firm's stock at a given point in time.⁸⁵ The stock price is the market's best guess as to the value of the residual claim (the market value of the firm's equity), but it is just a guess, and it can be influenced or distorted by a variety of factors, including market imperfections that say nothing about the future income stream of the firm's assets. A company's stock price may be vulnerable to manipulation or noise trading, and it is only as good as the information it is based on. Again, there is no magic number available at every moment that can tell us exactly what a company is worth. Even when sophisticated experts attempt to calculate a number, the best they can do is estimate a range.

For these reasons, profit maximization is a goal, a guiding principle. It operates as a tie breaker or a way to strike a balance between competing interests. No one knows for sure which choice of several will maximize profits. No one knows for certain when it is appropriate to operate with short-term or long-term goals. That is why managers have discretion and why the business judgment rule protects them from liability for informed, good faith decisions not involving self-dealing. Blair and Stout

84. *Id.* at 297.

85. Blair & Stout, *supra* note 3, at 313–14 & n.178.

are absolutely right to point out that corporate officers and directors have discretion to try to operate the company in the way they deem most successful. But the measure of success is profitable survival. There is no other.

There are, however, a number of decisions corporate managers could make that benefit shareholders as well as other constituents. That has to be true if we accept that shareholder value is the way we measure corporate well-being. And if we do not accept that shareholder value is the correct measure, we must designate some other way of determining whether something is good for a corporation. Corporations are only “healthy” if they can sustain a profitable business. If a business stops being profitable, it will either be taken over and made profitable or it will fail and liquidate.

Profit maximization is a goal, an aspiration, and not a fixed, calculable requirement. While corporate managers should be trying to maximize profits to the greatest extent possible within applicable constraints, the constraints are numerous and no one can be sure *ex ante*, or even *ex post*, whether a particular decision is profit-maximizing. No one who supports a shareholder primacy view of corporate governance would expect to be able to enforce a more specific standard. And because we cannot know how to maximize profit, and we do not have a particular definition of what profit maximization means or if it has been attained, strict profit maximization is not an appropriate standard, even under the shareholder primacy theory.

Instead, both shareholder primacy and corporate success require a balancing of interests, which makes them both consistent with, and not opposed to, Blair and Stout’s theory. Indra Nooyi, CEO of PepsiCo, explained it this way:

So what we did was we said, “Why don’t we make the shifting of the portfolio, offering more nutritious products, offering more greens, offering more fruits and vegetable offerings, really becoming an environmentally conscious company, and creating an environment at PepsiCo where everyone can bring their whole self to work. Part of the agenda as to how we make money, not how we spend the money, but how we make money, and that got encapsulated in these three words, “Performance with purpose.” It all started with performance. We want to deliver the greatest financial returns. But we want to deliver those profits while we transform our product portfolio, worry about the planet, and worry about our people. . . . And the fundamental difference between corporate social responsibility and performance with purpose is that performance with purpose is about how we make the money, not how we spend the money that we make. If we do not transform our portfolio, we

cannot make profits. If you're not environmentally sustainable, you won't get a license to open a plant and we won't reduce the costs of our packaging. And if we don't create a phenomenal workplace for our people, we won't be able to hire the best and the brightest. So our purpose became how we deliver the profits. Too often, I think, people confuse purpose with corporate social responsibility which is a problem because you could run the company any way and then just do a charity program in some country, and then feel good. That's corporate social responsibility. To me, that's like going to confession after you've made a mistake. I think what we are talking about is weave purpose into how you run the company, into how you make money, then it's a sustainable model and that's what performance with purpose is all about.⁸⁶

Profit—the bottom line—is the primary concern, and it drives how the other decisions are made and defines how to know if the reforms are making PepsiCo a better company. But because of the pressures from communities in which businesses operate—environmental laws, tax laws, immigration laws, labor laws, the labor market, the consumer market, the demands of creditors and other investors—profit must be maximized within constraints and can only be maximized at all if those constraints are honored. That is why profit maximization works with Blair and Stout's theory—shareholder profit is the goal that gives shape to the other relationships within the firm. Directors know what terms to agree to with all constituents and know how to prioritize various parties' interests because residual claim primacy is a guiding principle. This description of the balance among corporate constituents is the brightest contribution of *A Team Production Theory of Corporate Law*.⁸⁷

IV. CORPORATE GOVERNANCE BALANCE

As Blair and Stout point out, boards are not properly agents of shareholders because they are not bound to obey shareholders. They are also not great shareholder representatives for similar reasons.⁸⁸ As mentioned above, shareholders may have differing ideas about how the corporation should maximize profits. Because profit maximization is an art and not a science, shareholders, if well enough informed (and most are not), may have different opinions about the decisions the board should be making. Boards, then, are necessarily given a lot of discretion and their

86. Indra K. Nooyi Interview, *supra* note 63.

87. Blair & Stout, *supra* note 3, at 313–14.

88. Moreover, shareholders are, in part, responsible for monitoring the board, and the board cannot perform that function on shareholders' behalf.

decisions are protected from liability by the business judgment rule. Shareholder (or residual claim) primacy does not mean honoring the specific desires of any one shareholder or group of shareholders, or putting ordinary business decisions to a shareholder vote. It simply means operating the company with the goal of maximizing the value of the residual claim.

Larry Ribstein articulated the balance that managers must strike between profitability and responsibility and finds that one requires the other.⁸⁹ A business will only be profitable if it can convince investors, vendors, consumers, and employees, among others, to participate.⁹⁰ It needs to be able to raise capital at an affordable price, hire and retain good employees, operate in desirable locations at low costs, and appeal to customers, which includes appealing to customers' sensibilities about health and fairness.⁹¹

In order for each constituency to agree to make the firm-specific investments in the corporation at a price the company can afford, the corporation must grant each group some concessions that are important to them.⁹² Employees of a certain qualification will be able to demand a certain wage in the labor market. Shareholders and creditors will want rights against management that they can enforce if management starts performing poorly. Creditors reserve control and exit rights, and shareholders may demand a liquid market on which they can trade their stock and will be able to take advantage of the powers granted to them under state and federal law. Governments will require certain environmental standards be met or may impose other regulations in order to allow corporations to operate in a certain way. Consumers will demand that products reach them at a price consistent with the market for goods of that kind and quality, and may also make demands about the company's treatment of its employees or the environment, rewarding companies that seem particularly socially conscious by patronizing them more heavily.⁹³

89. Larry E. Ribstein, *Accountability and Responsibility in Corporate Governance*, 81 NOTRE DAME L. REV. 1431, 1436-42 (2005).

90. *Id.* at 1443.

91. The following sections discuss specific markets that encourage even managers who are responsive to shareholders' demands to attend to the interests of nonshareholder stakeholders. In analyzing the markets that impinge on corporate decision making, it is important to keep in mind that they are potentially complementary. A firm that faces no demand for social responsibility in its product market, for example, might face such a demand when selling equity, hiring employees, or locating its headquarters. *Id.*

92. *Id.* at 1443-44 (distinguishing between "strategic" social responsibility and "altruistic" social responsibility).

93. Consumers may boycott companies they think are behaving particularly badly, thereby hurting the firm's bottom line.

Many companies make socially conscious policies and practices a part of their branding to better appeal to consumers. All of these concessions to other stakeholders allow the firm to maximize the value of its residual claim.⁹⁴

Making concessions to other stakeholders also means giving them control over the corporation at times when they may be particularly vulnerable. That means that, at various points in the corporation's life cycle, creditors may have more direct power over management than shareholders, or employees may be able to hold up the corporation's business by striking. Governments can also deny permits or fail to pass tax breaks that make doing business affordable. The widely dispersed shareholders of public corporations are not able to overcome their collective action problem well enough to directly represent themselves to management, and so they will have to watch helplessly (or sell their stock) when another constituency is able to exercise direct control over the firm. That does not mean that giving power to another stakeholder is against shareholder interest. It is simply a cost of doing business—the cost of enticing the stakeholder to participate in the firm at a price the corporation could afford. If shareholders are allowed to vote on whether to give the other stakeholder the right to exercise power in certain circumstances, they would likely vote to approve the deal. Profit is not free. The benefits of obtaining the stakeholders' investments exceed the likely costs of the concessions they are given, for the stakeholders may never get to—or have to—exercise the powers they have reserved. If all goes well, they will not need to.

The board—and more realistically, senior management—are responsible for balancing these rights, interests, and contracts and are responsible for making sure that they do not conflict and that the firm is still free to operate profitably. This is the mediating hierarch role that Blair and Stout write about. The board manages all of the stakeholder relationships with the firm—the nexus of contracts.⁹⁵ All of the contracts between the stakeholders and the firm fit together to form a working community of actors with various rights to the product of their team effort.⁹⁶ That product, the one everyone wants to be as large as possible given relevant constraints, is the value of the residual claim. Even fixed

94. *Id.* Of course, the short-term/long-term debate is relevant here. A number of these kinds of concessions may serve the company better in the long term than the short term. As discussed above, it is far from clear that short-termism is really very profitable for the vast majority of shareholders, so it is not clear that a short-term focus is consistent with shareholder primacy.

95. Blair & Stout, *supra* note 3, at 271.

96. *Id.* at 270–71.

claimants want the residual claim to be enhanced when the firm is healthy because that profitability ensures the firm's continued existence and saves the fixed claimants the costs of not being able to recover on their claims and of having to move their investment if the firm fails.

Blair and Stout are mistaken that the balance means that shareholder primacy is invalid. The balance is necessary to maximize profits.⁹⁷ And the balance is measured and struck according to its ability to allow the firm to operate profitably. Favoring the wrong stakeholder at the wrong time, or giving too much power to any particular stakeholder, can cause great damage to the firm. For example, it is not possible to measure *corporate* well-being solely by reference to the value realized by employees. Rather, the success of advantages given to employees is measured by the profitability and success of the firm and the firm's enhanced ability to deliver a good product to its customers.

The plight of General Motors in the early 2000s is an example of the problem of too heavily favoring a nonshareholder stakeholder. GM seems to have been operated for the benefit of its trade unions and creditors for years as those debts were so pressing and the company was constantly short of cash.⁹⁸ The unions had extracted significant concessions from the firm.⁹⁹ While workers were paid much higher wages than the industry average,¹⁰⁰ they were also paid for time off when there was not enough work for them to do,¹⁰¹ and they were given generous pensions that GM simply could not afford to honor.¹⁰² The firm stayed out of bankruptcy for years by operating very conservatively for the benefit of their fixed claimants (creditors and employees), and never realized success or significant profitability during that time because it was not taking chances on new products and was not making the adjustments necessary to keep up with changes in the product market.¹⁰³ The firm finally failed, asking for government assistance in 2008¹⁰⁴ and reorganizing in bankruptcy in 2009.¹⁰⁵ GM was able to limp along for years without much

97. Ribstein, *supra* note 89, at 1443–44.

98. Doug Altner, *What Explains GM's Problems with the UAW?*, FORBES (May 20, 2013), <http://www.forbes.com/sites/realspin/2013/05/20/what-explains-gms-problems-with-the-uaw/>.

99. *Id.*

100. *Id.*

101. *Id.*

102. *Id.*

103. Jeffrey A. Sonenfeld, *How Rick Wagoner Lost GM*, BUSINESSWEEK (June 1, 2009), http://www.businessweek.com/managing/content/jun2009/ca2009061_966638.htm.

104. Brian Ross & Joseph Rhee, *Big Three CEOs Flew Private Jets to Plead for Public Funds*, ABC NEWS (Nov. 19, 2008), <http://abcnews.go.com/Blotter/WallStreet/story?id=6285739>.

105. Chris Isidore, *GM Bankruptcy: End of an Era*, CNN MONEY (June 2, 2009), http://money.cnn.com/2009/06/01/news/companies/gm_bankruptcy/.

success, but also without completely failing, even though it was not being operated for the benefit of the value of the residual claim. But it did not succeed, and ultimately became the poster child for the failure of running a for-profit corporation for some purpose other than shareholder profit. One of the biggest corporate failures of the last fifty years was not an example of short-termism taken to an extreme or shareholder primacy gone wrong; rather, employee primacy went wrong.

One significant hole in the shareholder primacy view of corporate governance as a descriptive matter is that managers can make any decision they want and can usually spin it as a potential benefit to shareholder value. Because profit maximization is an imprecise target and no one has perfect foresight, there is no way to know if a particular action could indeed benefit corporate wealth, and there is little recourse against management if a decision eventually proves to have been a bad one. It may be impossible to ever know whether one particular decision was a net benefit or harm to the firm's bottom line, and there is no guarantee we could find out in the near term even if we could know some day.¹⁰⁶ If we cannot know whether a particular decision benefits shareholder value, how can we say that maximizing shareholder value is the goal of managerial decision making?

Instead, we have to ask how managers' decisions are evaluated. They tend to be evaluated cumulatively, not singly, because stock price and other metrics of corporate success are the result of a large variety of factors of which each decision is only one. Blair and Stout would argue that we should trust managers to make the best decisions they can because managers have enough at stake in their own reputations that they will make good decisions for the world.¹⁰⁷ However, even if we did generally feel that managers could be trusted to make good decisions for the world when running their companies—and many do not agree that that is the case, including many who oppose shareholder primacy—we would still need some way to evaluate whether a decision was good for the company, or even the world. Larry Ribstein points out this problem with trying to legislate social responsibility—there is just no reliable, predictable, or fair way to do it.¹⁰⁸ There are as many different opinions about what is good for the world or a company as there are people who could give them. Society, shareholders, stakeholders, and even members of the

106. Margaret Blair raised this point in her presentation at the symposium. See Margaret M. Blair, *Boards of Directors as Mediating Hierarchs*, 38 SEATTLE U. L. REV. 297 (2015).

107. *Id.*

108. Ribstein, *supra* note 89, at 1432.

same board could disagree in good faith about what the morally correct decision is in any one circumstance.

That is why it is easiest and most reliable to measure managers against one relatively predictable metric to guide them in one direction, even as that direction leaves open many different paths and could be interpreted a variety of ways. Telling managers to maximize profits within certain constraints allows us, as a democratic society, to set constraints and also know what it is we are trying to limit. It keeps us from having to try to regulate the moving target that a managerial fiat would be and gives us predictable parameters with which to limit corporate action and decision making.

Many may feel that it is immoral to tell managers that “all they have to do” is maximize profit. As this Essay has argued, though, even that command leaves managers a great deal of discretion in how to manage corporate assets and make decisions about corporate activities. Maximizing profit does not mean just one thing, and many limitations restrict a manager’s ability to drive toward the one, heartless goal. Rather, there are many benefits to considering other interests in the pursuit of profit. Creativity and good citizenship are often rewarded with profits, while irresponsible behavior is punished with economic failure.

At the same time, the drive to “just maximize profits” does not really provide very much guidance. It results in a complicated decision making process that can result in a variety of decisions. For the reasons Blair and Stout describe, even with a shareholder primacy viewpoint, corporate governance is not truly limited, and managers retain a great deal of discretion. It may well be less moral and more troublesome to allow managers to elicit firm-specific contributions from stakeholders and then do whatever they wish with those assets with no particular goal or principle guiding their actions. Visibility and predictability allow for informed investment by all stakeholders and allow us to properly constrain corporate action for society’s benefit.

V. CONCLUSION

Blair and Stout’s team production theory does an admirable job of explaining the nexus of contracts theory of the firm and of situating the board of directors within that theory. The team production theory also explains how the board serves as a mediating hierarch to coordinate the rights and interests of various corporate constituents. Its description of the role of the board in corporate governance is convincing. Yet, Blair and Stout reject the validity of the shareholder primacy view of corporate governance in their account, and do so unnecessarily. This Essay has argued that shareholder primacy is, in fact, consistent with Blair and

Stout's team production theory. Once we adopt a realistic view of shareholder wealth maximization, or residual claim maximization, we see that it is an important principle that guides directors in their work as mediating hierarchs. It tells them how to balance corporate contracts, which interests to prioritize, and when to do so. This Essay reconciles the shareholder primacy and team production views in an effort to bring those who oppose shareholder primacy closer to those who advocate it.