THE COMPLEXITIES OF SHAREHOLDER PRIMACY: A RESPONSE TO SANFORD JACOBY

Brishen Rogers†

We live in interesting times. In early October 2008, as I write this response to Sanford Jacoby's analysis of financial development and inequality, policymakers around the world are struggling to respond to the worst financial crisis since the Great Depression. In many ways, Jacoby's work helps explain the root of this crisis by focusing our attention on how the past few decades of financial deregulation—including the repeal of Glass-Steagall, the enactment of finance-friendly tax code revisions, and the decision to leave derivatives largely unregulated—enabled excessive risk-taking throughout the markets.[1] Lately, many have been criticizing such decisions and debating the extent to which they precipitated the crisis.

Less debated has been the connection, if any, between corporate governance and the meltdown. Over the past few decades, corporate governance has changed dramatically. Shareholder activists have established declassified boards and majority vote requirements as the default standard among S&P 500 companies, tied successive SEC Chairmen in knots over proxy access, and kept boards on their toes through "withhold" or "just vote no" campaigns. This reflects a confluence of factors, including the growth of institutional investors, SEC and Department of Labor decisions encouraging activism, the influence of "shareholder primacy" norms in corporate governance, and Sarbanes-Oxley's emphasis on director independence as one remedy for the financial malfeasance of the Enron era. Yet markets have gone off a cliff once again.

† Climenko Fellow and Lecturer in Law, Harvard Law School.

1. We might now add the SEC's decisions to lower broker-dealers' capital requirements and to grant credit rating agencies quasi-official status, Congress' and the SEC's failure to regulate hedge funds, and a monetary policy that sought to prop up domestic spending in an era of declining real income by inducing excessive consumer debt, to name but a few. *See*, *e.g.*, Damon Silvers, *How We Got Into This*, THE AMERICAN PROSPECT (Apr. 21, 2008).

While Jacoby doesn't explore the idea, I expect he'd argue that the phenomena are linked, or at least share some common roots. He views the rise of "agency theory" within corporate governance scholarship, and its focus on holding directors and managers closely accountable to shareholders and shareholders only, as providing a key ideological underpinning for the financial sector's recent dominance of developed nations' politics.

This leads him to stake out a unique position on the long-running debate over the virtues of institutional shareholder activism. While some have celebrated activism for its potential to solve the principal-agent problem at the heart of corporate governance, others have argued that it merely "shifts the locus" of that problem, and that union and public funds use activism "to reap private benefits not shared with other investors."[2] Jacoby, in contrast, criticizes union funds from the left. "The problem," he says at one point, is that union funds "frequently sound as if they are in favor of shareholder primacy."[3] Rather than consistently supporting initiatives that will help workers while also bolstering firms' long-term performance, Jacoby argues, union funds too often support mainstream corporate governance initiatives that enhance shareholders' power within the corporation, enabling shareholders to extract more of the firm's wealth, and leaving less for workers.

He would instead press unions to resurrect the core ideals of mid-century "producerism," where scholars understood the "corporation [as] an entity distinct from its shareholders"[4] and managers viewed themselves as having "four broad responsibilities: to consumers, to employees, to stockholders and to the general public," with "each group . . . on an equal footing"[5] He thus applauds various unions' attempts to rein in private equity and hedge funds, and would likely celebrate the AFL-CIO's recent efforts to protect working families in the negotiations over the Poulson-proposed Wall Street bailout.

---

2. Stephen Bainbridge, *Shareholder Activism and Institutional Investors* 15 (UCLA School of Law, Law & Econ. Research Paper No. 05-20, Sept. 2005), *available at* http://ssrn.com/abstract=796227; see also Roberta Romano, *Less is More: Making Shareholder Activism a Valued Mechanism of Corporate Governance*, 18 YALE J. REG. 174, 231–32 (2001) (cited by Bainbridge, noting possibility of public funds sponsoring proposals to enhance their political reputation or union funds doing so to make progress on labor rights).

3. Sanford M. Jacoby, *Finance and Labor: Perspectives on Risk, Inequality, and Democracy*, 30 COMP. LAB. L. & POL'Y J. 17, 50 (2008).

4. *Id.*

5. *Id.*; later on Jacoby notes that labor's mid-century political and economic power led key labor leaders to support the Bretton Woods agreement and to fight for progressive taxation as key means to support egalitarian domestic programs, *id.* at 26 (quoting FRANCIS X. SUTTON ET AL., THE AMERICAN BUSINESS CREED 64–65 (1956)).

While I share Jacoby's support for such initiatives, I'm a bit less skeptical than he is about union funds' shareholder activism, for at least two reasons. First, I believe that the growth of shareholder primacy as a key norm in corporate governance has had more complex effects than he acknowledges. On the one hand, top actors in corporate governance, including Chancellor Leo E. Strine, Jr. of the Delaware Court of Chancery,[6] Martin Lipton,[7] and the diverse participants in the Aspen Institute's Corporate Values Strategy Group,[8] have all recently argued that short-term investors' dominance in today's capital markets—a phenomenon linked to shareholder primacy—poses acute challenges to long-term value creation as well as broader social goals. On the other, the mantra that directors and managers should be directly accountable to shareholders has greatly bolstered union funds' and other progressive shareholders' efforts to enhance corporate social responsibility efforts. I explore this issue in more depth in Section I, below.

Second, Jacoby may be overestimating the extent to which "shareholder primacy"—or its more aggressive cousin "shareholder wealth maximization"—have actually been written into corporate law. While those ideals have certainly animated discussions of corporate governance, corporate law itself has instead consistently protected directors' prerogatives to govern in the best interests of the firm as a whole. In this light, union funds' governance activism might be best understood as an effort to shift the locus of corporate social responsibility from the proxy process into the boardroom, as I explore in Section II.

I. THE COMPLEXITIES OF SHAREHOLDER PRIMACY IN CORPORATE GOVERNANCE

While debates over whether corporations should be accountable only to shareholders or also to "stakeholders" have been around since the early twentieth century,[9] the now-dominant understanding of corporate law and corporate governance among academics and

6. Leo E. Strine, Jr., *Toward Common Sense and Common Ground? Reflections on the Shared Interests of Managers and Labor in a More Rational System of Corporate Governance*, 33 IOWA J. CORP. L. 1 (2007).

7. Martin Lipton & Paul K. Rowe, *The Inconvenient Truth about Corporate Governance: Some Thoughts on Vice-Chancellor Strine's Essay*, 33 J. CORP. L. 63 (2007).

8. *See* http://www.aspeninstitute.org/site/c.huLWJeMRKpH/b.2286629/k.5EAB/Corporate_Values_and_Strategy_Group.htm.

9. *See*, *e.g.*, Lynn A. Stout, *New Thinking on "Shareholder Primacy"* 3 (draft of Jan. 10, 2005), *available at* http://www.law.ucla.edu/docs/bus.sloan-stout.pdf.

financial elites is a relatively recent historical development, rooted in the ascendance of Chicago-school law and economics in the 1970s. Since that time, thinking on corporate governance in the U.S. has generally held that "the relationship between the stockholders and the managers of a corporation fits the definition of a pure agency relationship,"[10] where shareholder/owners hire directors and executives to act on their behalf. As Margaret Blair and Lynn Stout have noted, this principal-agent model of the firm has led scholars to focus on two recurring issues: "First, that the central economic problem addressed by corporation law is reducing 'agency costs' by keeping directors and managers faithful to shareholders' interests; and second, that the primary goal of the public corporation is—or ought to be—maximizing shareholders' wealth."[11]

As Jacoby argues, agency theory didn't just rebalance "the relationship between shareholders on the one hand and boards, executives, and other stakeholders on the other; it simply cut off the latter part of the scales."[12] It explained the 1980s takeover wave as a means of reallocating corporate assets to their highest-valuing users, and provided a ready critique of anti-takeover laws and Board-adopted defensive measures such as the poison pill. By changing director election procedures and eliminating takeover defenses, the thinking went, directors and officers could be best restrained from building empires, slacking, or otherwise using corporate assets wastefully. Given the liquid and efficient market for equities, moreover, benefits flowing to shareholders could be measured with scientific precision, unlike benefits granted to other corporate constituencies who, in any event, could adequately protect themselves through contract.

Agency theory and shareholder primacy norms also helped spark the rise of shareholder activism over the past two decades, and its acceleration in the years since the scandals that led to Sarbanes-Oxley. Two major shareholder networks—the Council of Institutional Investors (CII) and the International Corporate Governance Network

10. Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure* at 6, *available at* http://papers.ssrn.com/abstract=94043, *previously published* 3 J. FIN. ECON. 305 (1976); see also works cited in Margaret Blair & Lynn Stout, *A Team Production Theory of Corporate Law*, 85 VIRGINIA L. REV. 247, 248 n.1 (1999).

11. Lynn & Stout, *supra* note 10, at 248–49. As Jensen and Meckling put it, "the issues associated with the 'separation of ownership and control' in the modern diffuse ownership corporation are intimately associated with the general problem of agency." Jensen & Meckling, *supra* note 10 at 6.

12. Jacoby, *supra* note 3, at 32.

(ICGN)—have helped lead this transformation, with substantial involvement from union funds.[13]

Both groups embrace shareholder primacy ideals. For example, the "Corporate Governance Policies" promulgated by CII, a network of U.S. corporate, union, and public funds with over $3 trillion in assets, state early on that "corporate governance structures and practices should protect and enhance accountability to, and ensure equal financial treatment of, shareowners," adding that "[a]n action should not be taken if its purpose is to reduce accountability to shareowners."[14] Likewise, when ICGN Executive Director Anne Simpson testified before a 2007 Senate hearing on shareholder rights and proxy access, she echoed the agency theory: "Shareholders provide capital to companies; boards are given the task of overseeing the deployment of that capital; shareholders ensure that their interests are protected through being able to hold the board to account."[15] Over time, such groups have succeeded in moving various governance initiatives from the margins to the mainstream, including majority vote policies, board declassification, independent chair policies, and advisory votes on executive compensation.

Ironically, the notion that managers and directors should be more directly accountable to shareholders has also helped bolster efforts to increase "corporate social responsibility." Modern CSR initiatives date back to the early 1970s, when the SEC amended the proxy rules to allow more shareholder proposals on public policy issues, and

13. Union funds have long been an integral part of these networks. Bill Patterson was on CII's Executive Committee for a number of years starting in 1988, and was Co-Chairman for a period in the mid-1990s. UNITE-HERE President Bruce Raynor is a current Co-Chair, and leaders from the Laborers and Sheet Metal Workers serve on its board. *See* http://www.cii.org/about/council_board. Likewise, a representative of the Laborers was on the initial coordinating committee of the ICGN after its founding in 1995, and union officials are frequent speakers at ICGN conferences. *See* http://www.icgn.org/organisation/founding.php. Union representatives also have consistently influenced the development of policy through participation in ISS's policy development sessions each year, and by lobbying ISS directly to support various initiatives.

14. CII's policies support majority vote policies, having an independent chair or independent lead director, proxy access, counting broker non-votes and abstentions only for quorum purposes only, advisory votes on executive compensation, and detailed restrictions on executive compensation. *See* http://www.cii.org/policies.

15. Anne Simpson, Testimony to a Hearing of the United States Senate Committee on Banking, Housing & Urban Affairs 4 (Nov. 14, 2007), *available at* http://www.icgn.org/organisation/documents/sri/senate_hearing.php; ICGN also frequently communicates its views on corporate governance issues with national governments and international organizations including the European Commission, the OECD and the World Bank. For example, in a recent letter commenting on proposed changes to the Dutch Corporate Governance Code, the ICGN took issue with a number of proposed changes that "seem to be intended to restrict the activities of activist shareholders." *See* www.icgn.org/organisation/documents/sri/ICGN_Response_Frijns_Committee_12_Sept_08.pdf.

gained additional prominence in 1980s fights over apartheid.[16] In recent years, CSR proposals have become a critical element in efforts to combat global warming. For example, Ceres, a major coalition of investors, environmental activists, and companies founded in 1989, has long been pressing companies to increase their disclosure of environmental as well as financial performance.[17] More recently, working together with the U.N. Environmental Program, Ceres started and spun off the "Global Reporting Initiative," an effort to establish common guidelines for "triple bottom line" reporting of economic, environmental, and social issues. Its Web site boasts that over 600 organizations now report using the GRI.

Ceres has also started the "Investor Network on Climate Risk," which brings together major institutional investors concerned about climate change.[18] The group has proven particularly adept at utilizing the proxy process to convince companies to enhance their climate risk disclosure and/or change their practices. In 2008, it says, "[a] record 57 climate-related shareholder resolutions were filed with U.S. companies, of which nearly half were withdrawn after the companies agreed to positive climate-related commitments." Many non-withdrawn resolutions also received substantial support, including nearly 40% support for a global warming-related resolution at the coal company CONSOL. The group also convinced Ford Motors to commit to reducing its greenhouse gas emissions from its vehicles, and led two major homebuilders to increase their homes' energy efficiency.[19] It's worth noting that union funds, while better known for their governance activism, have also played a critical role in these initiatives: union fund leaders serve on Ceres' Board, and are listed as members of INCR.

CSR proponents have also utilized the proxy process to push companies to change their international labor practice. For example, several years ago the Connecticut state pension fund withdrew a proposal around labor standards in Asia at Sears after the company agreed to increase its monitoring of labor conditions; the fund also began working together with McDonalds and Disney on a project to determine how to improve labor standards in China.[20] Similarly, the New York City funds have introduced shareholder proposals at

16. *See*, *e.g.*, JAY EISENHOFER & MICHAEL BARY, HANDBOOK OF SHAREHOLDER ACTIVISM HANDBOOK §§ 3-10, 3-18 (2007).

17. *Id.* § 3-17.

18. *See* http://www.ceres.org/NETCOMMUNITY/Page.aspx?pid=427&srcid=554.

19. http://www.incr.com/NETCOMMUNITY/Page.aspx?pid=227&srcid=232.

20. *See* Dan Harr, *State Treasurer is Reform Activist*, THE HARTFORD COURANT (Jan. 24, 2005).

numerous companies asking them to implement ILO and UN human rights norms into their international operations and agree to independent monitoring. In 2006 various companies including Goodyear, Mattel, and Limited agreed to do so[21]; the next year Bed Bath and Beyond followed suit.[22]

The voting policies of the influential proxy advisory Institutional Shareholder Services (ISS), now a part of the larger firm RiskMetrics, likewise demonstrate the complex effects of shareholder primacy. ISS dominates the market for proxy advising; many believe that it controls as many as 40% of the votes in any given contest, allowing its decisions to make or break a corporate governance proposal, but also leading boards, their representatives, and even scholars to question its legitimacy.[23] Crucially, ISS also makes voting recommendations to its clients on CSR initiatives. According to its proxy voting guidelines for the 2008 season, the group generally supports proposals requesting reports on various social issues—including sustainability, environmental policy, product safety and toxic materials, and animal welfare—though not necessarily for mandated standards in such areas. It also supports proposals to adopt various international labor standards on a case-by-case basis, taking into account whether or not the company has "a code of conduct with standards similar to those promulgated by the International Labor Organization," whether it "participat[es] in fair labor organizations," and whether unions have any presence in its international factories.[24]

How to square such activities with the "shareholder primacy" norm? Many have described them as manifesting "enlightened shareholder value," on the theory that taking non-shareholder constituencies into account will aid profitability and shareholder wealth creation in the long-term. For example, according to a recent petition for SEC rulemaking around climate risk disclosure by Ceres and others, "Companies' financial condition increasingly depends upon their ability to avoid climate risk . . . and to capitalize on new business opportunities by responding to the changing physical and

21. New York City Comptroller's Office, The New York City Pension Funds' 2006 Shareholder Proposals 10–11, *available* at http://www.comptroller.nyc.gov/burearus/bam/corp_gover_pdf/2006-shareholder-report.pdf.

22. New York City Comptroller's Office, Post Season Report, 2007 Shareholder Proposal Programs 3, *available at* http://www.comptroller.nyc.gov/bureaus/bam/corp_gover_pdf/2007-Shareholder-report.pdf.

23. *See* Robert D. Hershey, Jr., *A Little Industry With a Lot of Sway on Proxy Votes*, N.Y. TIMES, June 18, 2006; Paul Rose, *The Corporate Governance Industry*, 32 J. CORP. L. 101 (2007).

24. RISKMETRICS GROUP, 2008 U.S. PROXY VOTING GUIDELINES SUMMARY 51-2 (Dec. 17, 2007), *available at* http://www.riskmetrics.com/sites/default/files/2008PolicyUSSummary Guidelines.pdf.

regulatory environment."[25] Similarly, Professor Lawrence Mitchell has argued that "Corporate management that looks to the best interests of the business over the long term will largely, if not completely, fulfill many of the goals of CSR."[26]

Others link corporate social responsibility to shareholder primacy by arguing that noncompliance with legal obligations will lead to financial or reputational harms. Cynthia Williams, for example, has argued that even "economic" investors without a social agenda have reason to desire corporate disclosure about social responsibility beyond mere legal compliance because "today's social issue is tomorrow's financial issue."[27] Investors have often echoed this rationale. A senior official at TIAA-CREF, for example, recently explained that some "social issues have long-range implications for the company's profits. If a company has poor policies on labor or diversity and it leads to fines, it changes from a social issue to a financial issue in a hurry."[28]

But such explanations aren't wholly convincing. It's a bit circular for a shareholder to demand monitoring of labor compliance in the name of financial performance when compliance could itself harm the company's financials. While scandals around mistreatment of workers do occasionally erupt and cause substantial reputational harms, a pure economic shareholder would likely calculate the payoffs from suppressing knowledge of such acts, discounted by the probability of discovery and the possible economic loss stemming from any bad press. It seems quite doubtful ex ante that such a calculation would lead, in all instances, to the conclusion that stamping out the bad behavior will enhance shareholder wealth.

The argument for climate risk disclosure is a little more nuanced. Since we already know some companies are polluters and promoters of fossil-fuel consumption, the possibilities of reputational harm aren't quite as dramatic. There's a stronger argument that information about risks from climate change would be helpful for a long-term investment strategy, but a rational wealth-maximizer would likely seek to limit broad disclosure of climate change risk and current

25. Petitions for Rulemaking: Request for Interpretive Guidance on Climate Risk Disclosure 7 (2007), *available at* http://www.sec.gov/rules/petitions/2007/petn4-547.pdf.

26. Lawrence Mitchell, *The Board as a Path Toward Corporate Social Responsibility*, *in* THE NEW CORPORATE ACCOUNTABILITY: CORPORATE SOCIAL RESPONSIBILITY AND THE LAW 279, 281 (2007).

27. *See*, *e.g.*, Cynthia A. Williams, *The Securities and Exchange Commission and Corporate Social Transparency*, 112 HARV. L. REV. 1197, 1284 (1999).

28. EISENHOFER & BARY, *supra* note 16, § 3-12 (quoting D. Nicklaus, *Mutual Fund Ballots are no Longer Secret with New Disclosures*, ST. LOUIS POST DISPATCH, Sept 1, 2004).

pollution, going long on such companies until their poor environmental stewardship starts to catch up to them, while also looking out for good investments in green tech. Activists' longstanding response to such critiques is that, as "universal owners" broadly diversified across the entire market, they don't have the luxury of divesting from poorly performing companies. While that may be generally true of union funds, many public funds are no longer the long-term universal owners they once were, as Jacoby notes, and recently have sought more and more "alpha" through active trading.[29]

The simplest explanation may be the best. Progressive shareholders wear multiple hats, and desire both financial returns and social responsibility, but frame their arguments in terms of shareholder primacy and long-term value creation in order to gain legitimacy with mainstream investors. Ceres and related investor networks, in other words, represent efforts to bring social concerns into U.S. corporate governance. We might think of this as indicating some daylight between "shareholder primacy" and "shareholder wealth maximization"—the former arguably supports such initiatives, the latter does not.

At best, however, this is a partial response to Jacoby's critique. He'd likely view the bolstering of CSR by shareholder primacy ideals as a desirable byproduct of an otherwise misguided campaign to reduce managerial discretion—including discretion to work together with labor. As I explain in the next section, however, I don't agree that the rise of agency theory has reduced managers' discretion as a matter of law.

II. THE PERSISTENCE OF DIRECTOR PRIMACY IN CORPORATE LAW

While "shareholder primacy" certainly dominates discussions of governance initiatives, whether it has been written into corporate law is another matter.[30] Under Delaware law the board of directors, not the shareholders, enjoys the power to manage the firm. Granted, shareholders enjoy several important rights they may use to hold directors accountable: they can vote, can sue, and can sell their shares. But as Lynn Stout notes, "these rights are of remarkably little

29. Jacoby, *supra* note 3, at 24–25.

30. Jacoby notes that a "new realism is emerging in legal scholarship that challenges shareholder primacy and supports a more balanced approach," citing some of the same authors whose works I explore in this section. *Id.* at 51 n.72. We draw somewhat different conclusions from that literature.

value to shareholders seeking to force managers of a public company to act as their 'agents' and serve only their interests."[31]

Consider voting rights. In Delaware, shareholders enjoy two basic voting rights—the right to elect directors, and to decide on certain "fundamental" changes such as mergers and charter and bylaw revisions. Yet they generally cannot place candidates for the board on the company's proxy, forcing them to bear the substantial costs of proxy solicitations and effectively negating the right to nominate directors. Nor can they force revisions of merger agreements, but rather must vote them up or down as proposed.[32]

Even more importantly, shareholders can rarely prove breaches of fiduciary duty except in cases of fraud or self-dealing. The "business judgment rule" insulates directors from liability for decisions made on an informed basis, in good faith, and "in the honest belief that the action taken was in the best interests of the company."[33] As Blair and Stout note, "case law generally interprets the 'best interest of the company' to include non-shareholder interests, including those of employees, creditors, and the community."[34]

In an article interpreting these and other quirks of corporate law, Blair and Stout argue that since agency theory apparently can't explain Delaware doctrine, scholars should understand the corporate board not as the agent of shareholders, but rather as a "mediating hierarch" that "encourage[s] firm-specific investment in team production by mediating disputes among team members about the allocation of duties and rewards."[35] Indeed, they argue that directors and officers of the corporation are not *agents* of the shareholders in the legal sense of the word at all. Under agency law, "the principal enjoys control over, and has the power to direct the actions of, the agent."[36] The relationship between directors and shareholders, they argue, is better characterized as a trustee relationship.

31. Stout, *supra* note 9, at 8.
32. Blair & Stout, *supra* note 10, at 310–11.
33. *Id.* at 300, quoting Smith v. Van Gorkum, 488 A.2d 858, 872 (Del. 1985).
34. *Id.* at 301.
35. Blair & Stout, *supra* note 10, at 278, 325–28 (1999). Blair and Stout also note that agency cost theory has little to say about the peculiarities of employment contracts; Stout, in a separate piece, notes that shareholder primacy has been significantly challenged by recent arguments that any theory of corporate law must be able to explain the separation of ownership from control and capital lock-in, and from recent critiques of the efficient markets hypothesis and the rational goals of "universal shareholders" such as pension funds. *See* Stout, *supra* note 9, at 16–25.
36. Blair & Stout, *supra* note 10, at 290 citing Restatement (Second) of Agency § 385 (1958).

Nor are Blair and Stout the only recent scholars to question the agency theory.[37] Einer Elhauge, for example, recently argued that the canonical law and economics account of corporate social responsibility—that "fiduciary duties require corporate managers to further the interests of shareholders, and thus to maximize corporate profits subject to the obligation to comply with independent legal constraints"[38]—is simply incorrect. Rather, Elhauge argues, "managers have never had an enforceable legal duty to maximize profits," and have always enjoyed "some legal discretion (implicit or explicit) to sacrifice corporate profits in the public interest."[39] Nor could it be otherwise, he argues, because the alternative to business judgment rule deference would be constant litigation over failures to profit-maximize, which would almost certainly increase total agency costs due to unpredictability.[40] Indeed, he argues, directors seem to enjoy the power to sacrifice some shareholder wealth to further the interests of other constituencies even in the Delaware Courts' *Revlon* cases, generally understood to hold that where sale of the firm is inevitable, the Board's sole function is to maximize shareholder value.[41]

By citing critics of the standard model such as Elhauge and Lynn & Stout, I risk implying that proponents of that model argue that it already permeates corporate law. Many do not. For example, in their 2001 article "The End of History for Corporate Law," Henry Hansmann and Reinier Kraakman argued that "There is no longer any serious competitor to the view that corporate law *should* principally strive to increase long-term shareholder value."[42] They implied that U.S. corporate law fell short of full accord with the shareholder primacy model, though were hopeful that it would soon change. Likewise, Lucian Bebchuk has recently argued that shareholders should—but do not yet—have the power "to initiate and vote to adopt changes to the company's basic corporate governance

37. *See also* Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance* (UCLA School of Law Research Paper No. 02-06, 2002), *available at* http://ssrn.com/abstract=300860.

38. Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 NYU L. REV. 733, 736 (2005).

39. *Id.* at 738.

40. Elhauge also views this as normatively desirable. Where managers are loyal to shareholders with views of the public interest, they will sacrifice profits accordingly; where they are not loyal to shareholders, nevertheless, "their exercises of profit-sacrificing discretion will generally still make corporate conduct more socially desirable." *Id.* at 740.

41. *See id.* at 852; see also Blair & Stout, *supra* note 10, at 309.

42. Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L. J. 439, 439 (2001) (emphasis added).

arrangements."[43] In another article, Bebchuk argues that shareholders' ability to replace directors, often cited by Courts and scholars as "a key mechanism for making boards accountable," is in fact a myth, and argues for a new set of default legal arrangements to make the franchise real by enabling such challenges.[44]

Critics and proponents of agency theory alike, then, seem to agree that it has not worked a revolution in corporate law doctrine. This is not to say that norms of "shareholder wealth maximization" do not influence corporate decision-making. On the contrary, firms that fail to deliver expected profits may be unable to access cheap capital through share issuances, or could even become takeover targets. Similarly, those who raise costs of production risk losing market share, and directors who resist takeovers may find themselves targets of "vote no" or "withhold" campaigns. Such factors, moreover, have arguably become more important to managers as capital and product markets have globalized and become more competitive in recent decades. Delaware Courts, however, by giving such deference to directors' informed decisions, nonetheless allow them a zone of discretion to take account of non-shareholder interests in numerous ways.

This may have important implications for how we understand union shareholder activism. My conclusions here are admittedly a bit speculative, but I believe consistent with the evidence. If shareholder primacy lacks much legal force, then unions and others could utilize shareholder efforts, not to advance economic goals, but rather to move the battlefield over corporate social responsibility from the proxy process to the boardroom. Proxy access, for example, could greatly enhance progressive shareholders' influence over corporate strategy. The business judgment rule is the key link: so long as directors are privileged to act in the public interest, progressive shareholders would be well advised to work in coalition, find moderate board candidates who share their social concerns, and elect them.

Indeed, such a spirit seems to be motivating AFL-CIO Secretary-Treasurer Rich Trumka's suggestion, cited by Jacoby, that labor

43. Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 837 (2005). Bebchuk argues that shareholders should be able to make "rules of the game decisions" such as charter amendments or reincorporation in a new state, and "specific business decisions of substantial importance" such as decisions around mergers or efforts to "scale down" the firm. *Id.* at 838.

44. Lucian Arye Bebchuk, *The Myth of the Shareholder Franchise*, 93 VA. L. REV. 675, 676 (2007).

should elect directors who are "worker-friendly."[45] Such directors, once on the board, would receive business judgment rule deference for any decisions that implement a more social agenda. A similar rationale may explain union funds' support of majority vote policies, which constituted a strong minority of union fund proposals in the 2007 proxy season.[46] If momentum behind "withhold" initiatives targeting problematic directors continues to build in the coming years, one could envision progressive shareholders wielding their power to remove certain directors while negotiating for the appointment of allies.[47]

Other types of union fund activism raise different issues. Jacoby seems particularly concerned about activism against takeover defenses, which he argues may harm workers. But takeover defenses, although a particular focus for union funds in the 1990s,[48] have fallen off labor funds' agenda in recent years, minimizing this concern. Instead, most contemporary union fund activism seeks either to reform executive compensation—which Jacoby seems to support—or to change the election process.

Squaring this account with pension fund trustees' fiduciary duties under ERISA may be difficult, but perhaps not impossible. If we accept that shareholders have interests beyond simply the economic returns they expect from investments—if they also desire public goods such as a clean environment and socially just labor policies—then perhaps we should start to think of CSR initiatives as consistent with fiduciary duty *even if* they lead to somewhat diminished shareholders' returns.[49] After all, if corporate directors' fiduciary duties *already* allow them to consider the needs of other corporate constituencies, shouldn't ERISA trustees have a similar freedom? Of course, corporate directors will always be constrained to seek profits and keep costs down so as to maintain their financial soundness and competitive position, while ERISA funds face no such restraints. However, the duty of diversification under ERISA should prevent over-investment

45. *See* Jacoby, *supra* note 3, at 38.

46. *See* GEORGESON, 2007 ANNUAL CORPORATE GOVERNANCE REVIEW 35–41 (2007), *available at* http://www.georgeson.com/usa/download/acgr/acgr2007.pdf.

47. *See* Steve Gelsi, *Exxon Mobil proxy fights fueled by Rockefellers: Measure to separate chairman and CEO roles gains momentum*, MARKETWATCH (May 21, 2008); Exxon Mobil 10-Q (Aug. 5, 2008).

48. *See* Stewart J. Schwab & Randall S. Thomas, *Realigning Corporate Governance: Shareholder Activism by Labor Unions*, 96 MICH. L. REV. 1018 (1998).

49. Elhauge makes the similar point that where corporate managers are loyal to shareholders with views of the public interest, they will sacrifice profits accordingly. Elhauge, *supra* note 36, at 740.

in any particular firm that might suffer decreased returns due to social initiatives.

Another set of questions relates to whether labor and other progressive shareholders can utilize the proxy process and other activist initiatives to gain private benefits not shared with other shareholders.[50] Rather than an argument against shareholder activism per se, however, this may be an argument for bringing activists' goals into the open by allowing proxy access. An access rule that required sensible disclosures of candidates' views, and a majority vote for them to take office, would go a long way toward alleviating such concerns.

Agency theorists' concerns about ensuring shareholder wealth maximization, however, would remain. A full analysis of the *desirability* of that standard is beyond the scope of this article. My point is simply that our current corporate law might already be more stakeholder-friendly than it seems.

III. CONCLUSION

Union shareholder activism, then, may reflect a prudent response to the deregulation of financial markets. Where once labor disciplined corporations through collective bargaining and state-issued laws and regulations, today unions' shareholder activism could be a promising, albeit tentative, step toward distributive justice within firms, one undertaken not through legislative changes, and not resting on unions' state-granted powers of representation, but rather arising through private ordering processes. As financial markets have become more and more deregulated, we might even think of some of labor shareholders' recent efforts around risk management and executive compensation as attempts to accomplish through private agreement what financial regulators have proven unwilling or unable to do.

Nevertheless, the current financial crisis demonstrates precisely why we still need those agencies as powerful and active monitors. In fact, it seems to highlight the limits of a model of private ordering in the absence of a regulator that seeks out harmful behavior and imposes powerful sanctions for noncompliance. As outsiders to the firm without the knowledge and incentives to monitor firms' risk profiles, union and public fund activists can't be expected to anticipate and press for changes to head off major financial risks. Few if any

50. For an analysis of related issues in the context of hedge fund activism, see Iman Anabtawi & Lynn A. Stout, *Fiduciary Duties for Activist Shareholders*, STANFORD L. REV. 1255 (2008).

shareholders sounded alarm bells about escalating risks in the housing and financial sectors prior to the beginnings of the credit crisis in 2007, after all. The returns were just too good to pass up.

Polanyi's pendulum is indeed swinging today. It has already altered the landscape of financial regulation, though what will come next is unclear—perhaps a return to the sorts of explicit regulations that characterized the New Deal, perhaps something dramatically new. How it will alter the balance of power between shareholders and managers also remains to be seen. Despite my modest disagreements with Jacoby, I strongly agree with his assessment that a different, more egalitarian economic order can be built. The precise form it will take, he might note, will reflect not the exercise of apolitical expertise or the proper functioning of markets, but rather the contingencies of political power.