

“Enlightened Shareholder Value”: Corporate Governance Beyond the Shareholder-Stakeholder Divide

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I. INTRODUCTION	61
II. INSTITUTIONAL INVESTOR ACTIVISM: PANDORA’S BOX?	64
<i>A. Institutional Investor Power and the Rise of Shareholder Democracy</i>	65
<i>B. The Problem of Stakeholders</i>	69
III. STAKEHOLDERS UNDER CORPORATE LAW	71
<i>A. Shareholder Wealth Maximization</i>	73
<i>B. Control of the Firm</i>	76
<i>C. Shareholder Preeminence</i>	76
IV. DEFINING AND DRIVING ENLIGHTENED SHAREHOLDER VALUE: PATHWAYS BEYOND THE SHAREHOLDER–STAKEHOLDER DIVIDE	77
<i>A. Enlightened Shareholder Value Under the U.K. Companies Act</i>	77
<i>B. Investor-Driven Enlightened Shareholder Value</i>	80
1. <i>Expressions of Enlightened Shareholder Value: ESG Risk Management & the United Nations Principles for Responsible Investment</i>	80
2. <i>The ESG Rationale</i>	82
<i>a. Firm-Level Risk Management and Financial Performance</i>	83
<i>b. Portfolio-Level Risk Management and Financial Performance</i>	84
3. <i>Implementation & Diffusion</i>	86
<i>a. Institutional Investors & Enlightened Shareholder Value</i>	87
<i>b. Translating Enlightened Shareholder Value to Firms</i>	90
<i>i. Litigation</i>	92
<i>ii. Voting & Engagement</i>	93
V. SHAREHOLDER ENLIGHTENMENT AND THE CORPORATE OBJECTIVE FUNCTION	95
<i>A. Enlightened Shareholder Value: Revising the Corporate Objective Function</i>	96

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1. <i>The Enlightened Shareholder Value Alternative: Distilling Decision Rules</i>	96
a. <i>Enlightened Shareholder Value & Shareholder Wealth Maximization</i>	97
b. <i>Enlightened Shareholder Value Decision Standards</i>	99
i. <i>Long-Term Firm Value or “Joint Output”</i>	99
ii. <i>Two-tier Constrained Optimization</i>	100
2. <i>Enlightened Shareholder Value Decision Rules Under Corporate Law</i>	101
B. <i>Normative Advantages of Enlightened Shareholder Value</i>	102
1. <i>Of Law and Markets</i>	102
2. <i>The Nature of the Corporate Contract</i>	104
3. <i>Of Means and Ends</i>	105
4. <i>Stakeholder Representation</i>	106
C. <i>Enlightened Shareholder Value & The “Problem” of Stakeholders: Responding to Efficiency-based Concerns</i>	106
1. <i>“Too Little” Attention to Stakeholders</i>	107
2. <i>“Too Much” Attention to Stakeholders</i>	107
a. <i>A Response to the “Two Masters” Problem</i>	108
b. <i>A Response to the Problem of Private Interests</i>	109
VI. CONCLUSION	111

The global financial crisis has led to calls for greater corporate accountability and heightened controls over public corporations. As a result, the past year has seen a marked increase in regulatory initiatives that give shareholders a greater voice in corporate affairs. While debate continues to rage in the academy and beyond over the promise and pitfalls of these measures, an important undercurrent in the controversy is the potential impact of “shareholder democracy” on corporate stakeholders.

This Article urges a vision of the corporation and its purpose that transcends the shareholder–stakeholder divide. Under this “enlightened shareholder value” (ESV) approach, which has been introduced statutorily in the United Kingdom, attention to corporate stakeholders, including the environment, employees, and local communities, is seen as critical to generating long-term shareholder wealth.

This Article observes that a similar paradigm is being advanced in the United States by leading institutional investors who also identify stakeholder interests as key to long-term firm financial performance and effective risk management. It moves beyond prior literature by articulating a statement of the corporate purpose that is consistent with this investor-driven enlightened shareholder value approach and presents normative arguments in its favor. The Article then considers how enlightened shareholder value intersects with existing corporate governance rules in the United States and whether it implies managerial decision rules that align with or part course from the standard shareholder wealth maximization norm. In so doing, it offers a response to some of the concerns surrounding corporate stakeholders that have been raised by skeptics of greater

shareholder voice.

I. INTRODUCTION

Over the past decade, a rise in shareholder activism has sparked wide-ranging academic debate about the optimal role of shareholders in U.S. corporate governance and the benefits (and perils) of shareholder democracy.¹ These debates have attracted public attention in the wake of the global financial crisis, which has led to calls for greater corporate accountability and prompted renewed interest in the power of shareholders to police corporate management. Although debate continues to rage over whether shareholders can and will restrain corporate mismanagement, the past year has seen a marked increase in regulatory initiatives that give shareholders a greater voice in corporate affairs, including most recently the Dodd–Frank Wall Street Reform and Consumer Protection Act (Dodd–Frank Reform Act).²

An important undercurrent in the academic and popular controversy is the potential impact of shareholder democracy on corporate stakeholders, such as employees, creditors, the environment, and local communities.³ Director primacy proponents, who argue that control of the corporation is the proper purview of the board, not shareholders, note that corporate directors and officers already enjoy broad discretion under existing law to consider stakeholder interests.⁴ Shareholder empowerment might then disadvantage stakeholders by compelling management to focus solely on shareholder wealth maximization. Powerful shareholders might also pressure management to transfer value from stakeholders to shareholders.⁵

Opposite concerns are voiced as strongly that powerful shareholders will use their power to advance “special interests,” realize short-term gains, or promote narrow causes to the detriment of the firm⁶—even though some of the “causes” and “interests”

1. See *infra* notes 29–51 and accompanying text. Shareholder activism has been defined broadly as “the use of power by an investor . . . to influence the [behavior and impact] of a given portfolio firm [or firms].” Bruno Amann et al., *Shareholder Activism for Corporate Social Responsibility: law and practice in the United States, Japan, France, and Spain*, in *THE NEW CORPORATE ACCOUNTABILITY* 337 (2007).

2. See *infra* notes 26–39 and accompanying text (describing legislative initiatives and market changes preceding passage of the Act). Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

3. This Article uses the term “stakeholder” to refer solely to nonshareholders who bear risk of harm or loss as a result of the firm’s activities, following Max Clarkson’s risk-based stakeholder model. See STUART COOPER, *CORPORATE SOCIAL PERFORMANCE: A STAKEHOLDER APPROACH* 39–41 (2004) (describing Clarkson’s model) (citations omitted). As used here then, “stakeholder” is identical in scope to the alternative, but more cumbersome term, “nonshareholder constituencies” preferred by Stephen Bainbridge. See, e.g., Stephen Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 576 (2003) [hereinafter Bainbridge, *Director Primacy*]. Other variants might include all actors who “affect or are affected by” the corporation, but such definitions are too broad to be meaningful. See COOPER, *supra* at 38–41 (introducing various alternatives).

4. See *infra* notes 48–50 and accompanying text (describing the positions of some director primacy advocates).

5. See *infra* note 51 and accompanying text (presenting concerns that shareholder empowerment potentially threatens stakeholders).

6. See *infra* notes 43–47 and accompanying text (describing concerns that shareholder empowerment is

advanced are in fact the causes and interests of employees and other firm constituencies. In short, the problem with stakeholders is both that they might get too little attention and that they might get too much.

This Article engages with this aspect of the shareholder democracy debate by advocating an “enlightened shareholder value” vision of the corporate purpose that transcends the shareholder–stakeholder divide. Under this conception, attention to traditional “stakeholder” interests such as the effect of corporate operations on the environment, employees, or local communities, is seen as *a means of* generating long-term shareholder wealth and improving portfolio- and firm-level risk assessment. Enlightened shareholder value thus emphasizes the benefits to *shareholders* that can result from focusing corporate management on areas of shared shareholder and stakeholder concern while recognizing the very real challenges posed by the diversity of shareholder and stakeholder interests. At the same time, by asserting that shareholders should not achieve wealth through disregard for the impact of corporate decision making on stakeholders, enlightened shareholder value also parts course to some degree from the standard shareholder wealth maximization conception of the corporate purpose.

Enlightened shareholder value is not a novel concept, but has in fact already been statutorily introduced in the United Kingdom under the U.K. Companies Act of 2006.⁷ Theoretical precedent for the approach can be found in the narrower “enlightened stakeholder value” theory advanced by economist Michael Jensen.⁸ It also has parallels in the United Nations Principles for Responsible Investment (PRI), which urge analysis of stakeholder interests as part of firm- and portfolio-level risk management.⁹ Although there are good reasons to doubt that regulatory reform in the United States will follow the path of the United Kingdom, this Article points to indications that an enlightened shareholder value model is emerging in the United States, in part at the behest of major institutional investors.

A substantial literature spanning two decades has critically examined the role of institutional investors in promoting good corporate governance and supporting “responsible” business practices. Much of this literature concluded that institutional investor activism was unlikely to fulfill its hoped-for potential as a catalyst of corporate change, and cause for skepticism remains today.¹⁰ But the market and regulatory context has changed substantially since many of these studies of institutional investor activism were first undertaken. In particular, the rise of shareholder democracy has shifted the balance of corporate power toward shareholders, making their priorities more important to corporate boards. At the same time, movements across the economy favoring long-term investment strategies, “sustainable” business practices, and broader conceptions of

wealth-reducing).

7. The term “enlightened shareholder value” was first introduced in the legislation underlying the U.K. reforms to describe its stakeholder-oriented approach. See John Loughrey et al., *Legal Practitioners, Enlightened Shareholder Value, and the Shaping of Corporate Governance*, 8 J. CORP. L. STUD. 79, 82–87 (2008) (tracing the development of the concept during the U.K. legislative process); Cynthia A. Williams & John M. Conley, *An Emerging Third Way? The Erosion of the Anglo-American Shareholder Value Construct*, 38 CORNELL INT’L L.J. 493, 515–17 (2005) (same).

8. See *infra* note 200 (introducing Jensen’s theory).

9. See *infra* notes 107–09, 115 (introducing the UNPRI and its underlying rationales).

10. See *infra* notes 15–16 and accompanying text (surveying studies critical of institutional investor activism).

corporate accountability and risk management have created an environment in which shareholder and stakeholder interests are more likely to align.

Clear signs of a pro-stakeholder orientation among leading institutional investors can already be seen in initiatives to incorporate environmental, social, and governance (ESG) measures in firm and portfolio risk analysis, supported by both investor-led efforts to encourage sustainability reporting and trends in shareholder activism. To date CalPERS and other prominent public and union pension funds are at the forefront of many of these trends, with more moderate movement from mutual funds, which account for a significant percentage of U.S. equity holdings.¹¹ Nonetheless, because of its potential to generate long-term economic value for shareholders, facilitate more effective firm- and portfolio-level risk management, and improve the quality of information available to the markets, enlightened shareholder value—as defined in this Article—has appeal for mainstream investors and investment intermediaries that is already deepening its impact.

Although a limited number of prior studies have explored the possibility of an investor-driven enlightened shareholder value model in the United States,¹² this Article offers a new look at the potential of enlightened shareholder value to motivate market-driven corporate reform in light of current investor practices and recent regulatory measures that amplify shareholder voice. This Article is also the first to consider the implications of enlightened shareholder value for dominant conceptions of the corporate purpose. Moving beyond prior literature, it squarely considers how enlightened shareholder value intersects with existing corporate governance rules in the United States and the extent to which the paradigm represents a challenge to the standard shareholder wealth maximization norm as a guide for managerial decision-making. It also advances normative arguments in favor of the approach.

Part II sets a foundation for this investigation by reviewing the literature on institutional investor activism and outlining the nature of the “stakeholder problem” within the shareholder empowerment debate. Part III considers the space for stakeholders under current corporate law rules. Part IV introduces the alternative perspective offered by an enlightened shareholder value paradigm, its underlying rationales, and evidence of its growing influence among mainstream investors and financial intermediaries. Part V assesses the extent to which enlightened shareholder value fits within and also, paradoxically, challenges fundamental aspects of shareholder wealth maximization. In so doing, this Article responds to some of the concerns surrounding corporate stakeholders that have been raised by critics of greater shareholder voice.

11. See *infra* Part IV.B (examining trends toward investor-driven enlightened shareholder value). On the scale of pension fund and mutual fund holdings in the U.S. equity market, see *infra* note 19.

12. See Williams & Conley, *supra* note 7, at 523–30 (considering prospects for the United States to follow the United Kingdom’s enlightened shareholder value approach); David Hess, *Public Pensions and the Promise of Shareholder Activism for the Next Frontier of Corporate Governance: Sustainable Economic Development*, 2 VA. L. & BUS. REV. 221 (2007) (surveying public pension fund commitment to “long-term responsible investment”).

II. INSTITUTIONAL INVESTOR ACTIVISM: PANDORA'S BOX?

In the Berle-Means corporation, the separation of ownership and control produces powerful corporate managers who are largely unrestrained by the dispersed and rationally apathetic shareholders on whose behalf they are obligated to act.¹³ For much of the past century this classic model was a fairly accurate description of the American public corporation. It has also been credited with the economic successes of the United States and other shareholder-oriented jurisdictions.¹⁴

By the early 1990s, however, it had become apparent that U.S. equity shareholdings were increasingly concentrated among large institutional investors, that is, public and private pension funds, mutual funds, insurance companies, and banks. This sparked strong academic interest in the potential of these large investors to serve as quasi-regulators and true monitors of corporations and their boards.¹⁵ Much of this attention focused on the role of public pension funds because of the long-term investment perspective of their fund beneficiaries and the belief that these funds had fewer conflicts of interest, as compared to other institutional investors. This early optimism ultimately gave way in the face of considerable evidence of institutional investor passivity, short-termism, complex and indeed, conflicting interests, and the limited impact of investor activism on corporate behavior.¹⁶

However, one of the most striking developments impacting corporate America in recent years has been a dramatic shift in the balance of corporate power in the direction of shareholders, a shift which has reinvigorated interest in the questions surrounding institutional investor influence.¹⁷ This Article traces the rise of shareholder democracy

13. See generally ADOLF A. BERLE & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (1968). Even in the absence of shareholder monitoring, there are other sources of potential restraint on managerial slack or misconduct, including the market for corporate control. See JEFFREY D. BAUMAN, *CORPORATIONS LAW AND POLICY: MATERIALS AND PROBLEMS* 1079–81 (7th ed. 2010).

14. See, e.g., Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 450, 468 (2001) (asserting that corporate governance in key commercial jurisdictions has converged toward the “standard model” because the model has “outcompeted” alternatives).

15. See Douglas M. Branson, *Corporate Governance “Reform” and the New Corporate Social Responsibility*, 62 U. PITT. L. REV. 605, 630–35 (2001) (summarizing the literature and describing institutional investor activism as “the academic’s panacea” for corporate governance reform).

16. See, e.g., Roberta Romano, *Less is More: Making Institutional Investor Activism a Valuable Mechanism of Corporate Governance*, 18 YALE J. ON REG. 174, 176–82 (2001) (surveying the literature); MARK J. ROE, *STRONG MANAGERS, WEAK OWNERS: THE POLITICAL ROOTS OF AMERICAN CORPORATE FINANCE* (1994) (tracing institutional and political foundations of the fragmentation of share ownership in the United States); Roberta Romano, *Public Pension Fund Activism in Corporate Governance Reconsidered*, 93 COLUM. L. REV. 795 (1993) (identifying public pension funds’ conflicts of interest and susceptibility to political influence); Edward B. Rock, *The Logic and (Uncertain) Significance of Institutional Shareholder Activism*, 79 GEO. L.J. 445 (1991) (arguing that shareholder activism is unlikely to have a sustained impact as a source of corporate monitoring).

17. See, e.g., Richard Squire, *Shareholder Opportunism in a World of Risky Debt*, 123 HARV. L. REV. 1151 (2010) (describing how certain forms of contingent debt incentivize shareholder opportunism at the expense of creditors and the long-term financial health of the firm); Iman Anabtawi & Lynn Stout, *Fiduciary Duties for Activist Shareholders*, 60 STAN. L. REV. 1255 (2008) (arguing that the potential for self-interested shareholder activism necessitates the expansion of shareholder fiduciary duties); Randall S. Thomas, *The Evolving Role of Institutional Investors in Corporate Governance and Corporate Litigation*, 61 VAND. L. REV. 299 (2008) (introducing a symposium dedicated to institutional investors’ role in corporate governance);

and identifies the ways in which concerns over stakeholders continue to impact the shareholder empowerment debate.

A. Institutional Investor Power and the Rise of Shareholder Democracy

Since the turn of the century, the concentration of U.S. equity shares held by institutional investors accelerated to the point that as of 2006, their holdings represented two-thirds of the value of all U.S. public equities.¹⁸ Even with sharp declines in the equity markets since that time, institutional investor holdings still account for over 40% of U.S. publicly traded shares. Public and private pension funds alone now control, on average, around 20% of all equity shares in the United States, while mutual funds account for another 15%.¹⁹ Although diversification requirements prevent most institutional investors from owning 10% or more of any single portfolio company and most hold fewer than 3%,²⁰ as of 2008 institutional investors together owned 64.5% of the largest 1000 companies.²¹ This concentration of ownership increases the likelihood that management will attend to shareholder concerns and lowers collective action barriers to active investment strategies,²² creating leverage that makes the benefits of activism more worth the costs to any one investor. In addition, regulatory changes in recent years have stimulated greater activism among institutional investors by reducing proxy solicitation and voting costs and lowering other obstacles to investor influence of corporate decision-making.²³

Stephen J. Choi & Jill E. Fisch, *On Beyond CalPERS: Survey Evidence on the Developing Role of Public Pension Funds in Corporate Governance*, 61 VAND. L. REV. 315 (2008) (drawing on empirical evidence to explore patterns of institutional investor activism); Lisa M. Fairfax, *Making the Corporation Safe for Shareholder Democracy*, 69 OHIO ST. L. J. 53 (2008) (analyzing the impact of increased shareholder power on corporate stakeholders). See also *infra* notes 29–30 (surveying debates on the consequences of increased shareholder power).

18. CAROLYN K. BRANCATO & STEPHEN RABIMOV, THE CONFERENCE BOARD, 2008 INSTITUTIONAL INVESTMENT REPORT 6, 9, 20, tbls.1, 10 (2008). For an earlier assessment of these trends, see generally JAMES P. HAWLEY & ANDREW T. WILLIAMS, THE RISE OF FIDUCIARY CAPITALISM 42–68 (2000). Direct ownership of publicly traded equities is also concentrated among a relatively small number of wealthy individuals. See JEFFREY D. BAUMAN, CORPORATIONS LAW AND POLICY 509 (6th ed. 2007).

19. MATTEO TONELLO & STEPHEN RABIMOV, THE CONFERENCE BOARD, 2009 INSTITUTIONAL INVESTMENT REPORT 24–25, tbl.12 (2009). Over the past decade, the percentage of the total U.S. equity markets held by pension funds, both public and private, has averaged closer to 25%, compared to an average of 20% for mutual funds. *Id.* As of 2008, public pension funds, such as CalPERS, which invest for the benefit of state and local public employees, accounted for roughly 6% of the total equity market (down from nearly 10% in 2006). *Id.* This figure represents less than half of the aggregate equity holdings by mutual funds, which in 2008 stood at 15.3% of all equities (down from 33.4% in 2006). *Id.*

20. On diversification restrictions, see Bernard S. Black, *Shareholder Passivity Reexamined*, 89 MICH. L. REV. 520, 551–53 (1990); BAUMAN, *supra* note 18, at 509.

21. TONELLO & RABIMOV, *supra* note 19, at 26–27, tbls.13–14. The high concentration of institutional ownership among U.S. public companies was not impacted by the financial crisis. For nearly all of the top 25 U.S. public companies, the ten largest institutional investors in the company account for roughly 20 to 30% of its total outstanding equity. *Id.*

22. See Black, *supra* note 20, at 570.

23. For example, in 1992, the SEC amended the definition of “proxy solicitation” to remove most shareholder communications made without a formal proxy solicitation from the scope of federal regulation, and in 2007, amended the proxy solicitation rules to require Internet access to proxy materials, lowering cost barriers for activist investors. Regulation of Communications Among Shareholders, Exchange Act Release No.

As a result, pension funds, hedge funds, and even major mutual funds now engage in various forms of shareholder activism, often in coordination with one another. These strategies range from voting corporate proxies to informal negotiations with management, to shareholder proposals, proxy contests and shareholder litigation.²⁴ Recent empirical studies, while not uniform in their findings, indicate that in many cases investors' active monitoring can reduce agency costs and improve corporate financial performance.²⁵

Changing investment practices have also magnified shareholder voice. In their account of these trends, Anabtawi and Stout identify the rise of aggressive hedge funds, the emergence of shareholder proxy advisory services that concentrate investor voice, and the creation of complex financial instruments capable of separating voting rights and economic interests as key developments that have strengthened shareholder power.²⁶ The importance of strong "investor relations" is itself driving many companies to open new channels to engage with shareholders, including direct shareholder surveys and web-based communications.²⁷

34-31326, 56 Fed. Reg. 48276 (Oct. 16, 1992); Shareholder Choice Regarding Proxy Materials, Exchange Act Release No. 34-56135, 72 Fed. Reg. 42222 (Aug. 1, 2007) (codified at 17 C.F.R. pt. 240). *See* Anabtawi & Stout, *supra* note 17, 1281 n.98 (describing the proxy solicitation changes and the e-proxy rules as among the most significant reforms that have increased shareholder power). Rules introduced by the SEC in 2002 requiring mutual funds to disclose how they vote corporate proxies were also intended to encourage mutual funds to exercise voting rights independent of management, although studies to date have not identified a significant impact on mutual fund activism. *See* David Yermack, *Shareholder Voting and Corporate Governance*, 2 ANN. REV. FIN. ECON. 1, 15–16 (2010) (reviewing empirical evidence).

24. *See* sources cited at *supra* note 17, *infra* notes 156–89 and accompanying text.

25. A rapidly expanding empirical literature has explored the impact of shareholder activism forms on corporate financial performance, but findings vary depending on the form of activism, the impact measures, the time period, and the activist and target characteristics assessed. *See, e.g.*, Bonnie Buchanan et al., Proxy Rules and Proxy Practices: An Empirical Study of U.S. and U.K. Shareholder Proposals, (Sept. 15, 2009) (unpublished manuscript), available at <http://ssrn.com/abstract=1474062> (finding that shareholder proposals have positive, statistically significant effects on firms, and observing particularly strong effects for proposals by investors with large ownership stakes and those advocating certain governance reforms); Larry E. Ribstein, *Partnership Governance of Large Firms*, 76 U. CHI. L. REV. 289, 301 n.54 (2009) (collecting empirical findings on hedge fund activism); Brad M. Barber, Monitoring the Monitor: Evaluating CalPERS' Activism (Nov. 2006) (unpublished manuscript), available at <http://ssrn.com/abstract=890321> (estimating financial gains from CalPERS governance activism); Paul Gompers et al., *Corporate Governance and Equity Prices*, 118 Q. J. ECON. 107 (2003) (finding that companies with stronger shareholder rights exhibited higher returns); Jonathan M. Karpoff, The Impact of Shareholder Activism on Target Companies: A Survey of Empirical Findings (Aug. 18, 2001) (unpublished manuscript), available at <http://ssrn.com/abstract=885365> (assessing comparability challenges in on a meta-study of the literature). *But see* Yermack, *supra* note 23, at 16 (reviewing empirical evidence that targets of pension fund activism implement governance reforms but without significant effects on accounting measures of corporate value); Sanjai Bhagat et al., *The Promise and Peril of Corporate Governance Indices*, 108 COLUM. L. REV. 1803, 1814–15 (2008) (concluding that studies fail to show significant correlations between shareholder proposals and stock prices); Stuart L. Gillian & Laura T. Stark, *The Evolution of Shareholder Activism in the United States*, 19 J. APPLIED CORP. FIN. 55, 67 (2007) (noting limited evidence of long-term effects of activism on corporate operations or financial performance).

26. *See* Anabtawi & Stout, *supra* note 17, at 1280–81. The Dodd–Frank Reform Act introduces new regulations for hedge funds, derivatives, and investment advisers that are intended to curb the kind of excessive risk-taking that may have driven some of the trends observed by Anabtawi and Stout. Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010). *See also* Yermack, *supra* note 23, at 7–12 (surveying empirical evidence on shareholder activism, including the influence of proxy advisors and the effect of delinking voting and economic rights on shareholder power).

27. *See* REPORT OF THE TASK FORCE OF THE ABA SECTION OF BUSINESS LAW CORPORATE GOVERNANCE

Nonetheless, investors’ propensity for shareholder activism varies widely. For institutional investors, the fund size, degree of diversification, relative size of holdings in a given portfolio company, degree of investment in equity, investment time horizon, the investor’s commitment to non-financial performance, whether the fund is managed externally or internally, and the fund’s compensation structure all impact the investor’s level of activism and preferred approach.²⁸ Moreover, despite the strong shareholder-orientation of the American market and the market dominance of institutional investors—both proponents and opponents of greater shareholder power acknowledge that legal and practical limits have impeded the exercise of shareholder control—so that corporate boards have generally exercised nearly exclusive control over corporate affairs.²⁹ Over the past few years, these constraints have led to calls for deeper reforms that would expand shareholder voting rights and otherwise make corporate boards more directly accountable to shareholders.³⁰

Even before the passage of the Dodd–Frank Reform Act, many of these reforms had already been introduced or become standard practice among public companies in large part through the initiative of shareholders themselves. Through shareholder proposals under Rule 14a-8 of the Securities Exchange Act of 1934³¹ and various forms of engagement with corporate management, shareholders gained greater influence over corporate boards and attracted support for related legislative reforms.³² Proposals to replace plurality with majority voting for director elections, eliminate classified boards,

COMMITTEE ON DELINEATION OF GOVERNANCE ROLES AND RESPONSIBILITIES 14 (Aug. 1, 2009), available at <http://www.abanet.org/buslaw/committees/CL260000pub/materials/20090801/delineation-final.pdf> (surveying these developments).

28. See RODERICK MARTIN ET AL., INVESTOR ENGAGEMENT 36–59 (2007); Lori Versteegen Ryan & Marguerite Schneider, *The Antecedents of Institutional Investor Activism*, 27 ACAD. MGMT. REV. 554, 558 (2002); Choi & Fisch, *supra* note 17, at 352 (identifying institutional investor size, in terms of total assets under management, as the factor most highly correlated with activism).

29. The primary disagreement between advocates and skeptics of shareholder power is whether this state of affairs is desirable or not. These limits include (i) state corporate law rules that limit shareholder voting rights to director elections, approval of charter and bylaw amendments, and veto of extraordinary corporate actions, (ii) limits on access to the corporate proxy, (iii) disincentives to formation of large blocks of stock, (iv) limits on shareholder coordination and communication, and (v) a lack of mechanisms for shareholders to exercise direct influence over either operational decisions or what Lucian Bebchuk has termed “rules of the game” decisions. See generally Lucian A. Bebchuk, *The Case for Shareholder Access to the Ballot*, 59 BUS. LAW 43 (2003) (outlining arguments in favor of proxy access) [hereinafter Bebchuk, *Shareholder Access*]; Lucian A. Bebchuk, *The Myth of the Shareholder Franchise*, 93 VA. L. REV. 675 (2007) [hereinafter Bebchuk, *Shareholder Franchise*] (proposing reforms to strengthen director accountability to shareholders); Black, *supra* note 20, at 530–64 (highlighting legal obstacles to shareholder activism). See also Bainbridge, *Director Primacy*, *supra* note 3, at 569–72 (2003) (“[S]hareholder control rights are so weak they scarcely qualify as part of corporate governance.”); Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of the Corporation*, 85 VA. L. REV. 247, 310–12 (1999) (describing obstacles to shareholders’ ability to effect fundamental change).

30. See Bebchuk, *Shareholder Access*, *supra* note 29; Lucian A. Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833 (2005) [hereinafter Bebchuk, *Shareholder Power*]; Bebchuk, *Shareholder Franchise*, *supra* note 29.

31. 17 C.F.R. § 240.14a-8 (2010).

32. During the 2009 proxy season, governance proposals won on average between 45 and 67% shareholder approval. 2009 Proxy Season Scorecard, RISK METRICS, Dec. 15, 2009, http://www.riskmetrics.com/knowledge/proxy_season_watchlist_2009 [hereinafter 2009 Proxy Scorecard]. On shareholder–management negotiations, see generally Joseph W. Yockey, *On the Role and Regulation of Private Negotiations in Governance*, 61 S.C. L. REV. 171 (2009).

and expand shareholder rights to call special meetings have all received high levels of shareholder support in recent years.³³ Shareholders have also sought greater leverage with management by pushing for “say on pay” requirements that executive compensation be submitted to an advisory shareholder vote.³⁴

Though debate about the wisdom of such proposals remains heated,³⁵ the recent passage of the Dodd–Frank Reform Act makes many of these rules mandatory for public corporations.³⁶ For example, although majority voting was rejected in the final version of the Act, the legislation mandates “say on pay,” enhanced executive compensation disclosure, and elimination of “broker voting” for director elections, executive compensation, and other “significant matters.”³⁷ This sweeping legislation followed on the heels of other new rules effective this year that eliminated broker voting for director elections, authorized some investors to weigh in on executive compensation, and expanded shareholder monitoring of corporate risk management.³⁸ The Act has also paved the way for the SEC to enact shareholder proxy access regulations that further empower shareholders.³⁹ These new rules require companies to include a limited number of shareholder nominees for director elections in proxy materials at company expense, so long as the shareholder proponents meet certain eligibility requirements.⁴⁰ In addition,

33. Under plurality voting rules, which are the default under current state corporate laws, the directors with the most votes win, even though less than a majority of the shareholders have voted. Under a majority rule, in contrast, “withheld” votes are in effect votes *against* the candidate, which weakens management control over election outcomes. Most Fortune 500 firms have now adopted some form of majority voting. See Anabtawi & Stout, *supra* note 17, at 1283 & n.106 (citing a 2007 report on such policies).

34. See 2009 Proxy Scorecard, *supra* note 32.

35. At the time of this writing, the SEC proxy access rules enacted under the authority of the Dodd–Frank Reform Act are the subject of litigation filed by the U.S. Chamber of Commerce and the Business Roundtable and pending in the D.C. Circuit. *Business Roundtable v. SEC*, D.C. Cir., No. 10-1305 (Sept. 29, 2010). For academic arguments against expanded shareholder power that resonate in the ongoing debates, see Lynn A. Stout, *The Mythical Benefits of Shareholder Control*, 93 VA. L. REV. 789 (2007); Stephen M. Bainbridge, *Director Primacy and Shareholder Disempowerment*, 119 HARV. L. REV. 1735 (2006) [hereinafter Bainbridge, *Shareholder Disempowerment*]; Stephen M. Bainbridge, *The Case for Limited Shareholder Voting Rights*, 53 UCLA L. REV. 601 (2006) [hereinafter Bainbridge, *Limited Shareholder Voting Rights*]; Martin Lipton & Steven A. Rosenblum, *Election Contests in the Company's Proxy: An Idea Whose Time Has Not Come*, 59 BUS. LAW. 67 (2003).

36. Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

37. *Id.* §§ 951 (“say on pay”), 953 (executive compensation disclosures), 957 (limitations on broker voting).

38. On July 1, 2009, the SEC approved changes to the New York Stock Exchange’s Rule 452 to require brokers to receive specific voting instructions from their clients before voting those shares in uncontested director elections. Since investor silence no longer means “yes,” this change makes automatic confirmation of directors less assured and may give shareholders greater leverage with management. Order Approving Proposed Rule Change to Amend NYSE Rule 452 and Corresponding Listed Company Manual Section 402.08, Exchange Act Release No. 34-60215 (July 1, 2009), available at <http://www.sec.gov/rules/sro/nyse/2009/34-60215.pdf>. See also Proxy Disclosure Enhancements, 74 Fed. Reg. 68,334 (Dec. 23, 2009) (to be codified at 17 C.F.R. pts. 229, 239, 240, 249 & 274) (mandating enhanced risk management disclosure); Shareholder Approval of Executive Compensation of TARP Recipients, 75 Fed. Reg. 2,789 (Jan. 19, 2010) (to be codified at 17 C.F.R. pt. 240) (requiring companies that received Trouble Asset Relief Program (TARP) funds to permit shareholder advisory votes on executive compensation).

39. Dodd–Frank Act, § 971(a)–(b).

40. Exchange Act Rule 14a-11—the final SEC proxy access rule—limits these rights to certain

they authorize shareholder proposals seeking charter or bylaw amendments related to shareholder director nominations.⁴¹ At the time of this writing, the SEC is conducting a comprehensive review of the U.S. proxy system to improve its efficiency and transparency. This process may well result in further rule-making efforts to facilitate shareholder notice and access to the corporate proxy.⁴²

In sum, shareholder activism itself, changing market conditions, and regulatory changes have ushered in a new shareholder-oriented world for public corporations in which more investors are able and willing to take a greater role in shaping corporate decision-making and where corporations are more likely to take notice. However, whether this is a good thing for American corporations, their shareholders, and society as a whole depends in large part on how shareholders use their power. For some critics of shareholder democracy, the answer to these questions depends to at least some degree on whether shareholder voice benefits stakeholders.

B. The Problem of Stakeholders

Concerns about stakeholders have been raised from all sides of the shareholder empowerment debate. The basic objection to greater shareholder control raised by Stephen Bainbridge and other director primacy proponents is that the heterogeneity of stakeholder and shareholder interests makes centralized decision-making by the board of directors more, not less, essential to efficient management of the firm.⁴³ Expanding shareholder influence over corporate decision-making and decision-makers is suboptimal, then, because it is likely to undermine board discretion.

More strident critics of shareholder democracy fear that shareholder advocacy of stakeholder interests will balkanize boards, producing de facto “constituency directors” who speak for the interests of certain shareholders or stakeholders rather than for shareholders as a class.⁴⁴ With directors accountable to everyone, they would become accountable to no one.⁴⁵ At the very least, it is argued, shareholder advocacy of stakeholder interests and other “private” concerns will distract corporate managers from their duty to maximize shareholder wealth. This view was voiced most strongly perhaps

shareholders holding at least 3% of the outstanding voting shares for at least three years prior to its exercise of nominating rights. See Facilitating Shareholder Director Nominations, Release Nos. 33-9136, 34-62764, 75 Fed. Reg. 56,668 (Sept. 16, 2010), available at <http://www.sec.gov/rules/final.shtml>. The number of shareholder nominees is also limited. *Id.* at 56,674–76 (summarizing the requirements). The final rule amends Exchange Act Rule 14a-8 to permit shareholders to submit proposals related to director election and nomination procedures. 17 C.F.R. 240.14a-8 (2010). These rules at the federal level extend beyond recently enacted amendments to Delaware’s corporate code that permit companies to adopt bylaws giving shareholders proxy access at the corporation’s expense. DEL. CODE ANN. tit. 8, §§ 112–13 (2009). See also Facilitating Shareholder Director Nominations, *supra*, at 4.6671–72, 56.678–79 (explaining why the final rules reject an “opt-in” approach that would require companies to elect proxy access via bylaw amendment under state law).

41. *Id.*

42. Concept Release on the U.S. Proxy System, Exchange Act Release No. 34-62495 (July 14, 2010).

43. See generally Bainbridge, *Limited Shareholder Voting Rights*, *supra* note 35.

44. See Lipton & Rosenblum, *supra* note 35.

45. See *infra* notes 237–38 and accompanying text. The arguments for and against multi-stakeholder fiduciary duties and other rules that would give nonshareholders direct voice in corporate affairs are the subject of a vast literature beyond the scope of this Article. For responses in the context of the shareholder democracy debate, see Bainbridge, *Director Primacy*, *supra* note 3, at 608–15.

by Henry Manne, Dean Emeritus of the George Mason School of Law, in an op-ed on the dangers of shareholder proxy access, where he argued that “the laws of corporate governance should not countenance interference by those activists” who put “social causes, political movements or the reallocation of wealth” above profit maximization with the “contractually established expectations of the vast number of investors” who “are interested exclusively in maximizing their return on investment.”⁴⁶ To the extent institutional investors might use their influence to advance “personal or political agendas ahead of the [economic] interests of [their funds] beneficiaries,” director control becomes even more essential to preserving the economic value of the firm and avoiding costly wrangling over competing and potentially value-reducing investor priorities.⁴⁷ In essence, too much attention to stakeholder interests is wealth-reducing and is therefore bad for the firm and bad for shareholders.

Other skeptics of greater shareholder power affirm the importance of attention to stakeholders but observe that corporate directors and officers are already well-positioned to attend to stakeholders under existing law.⁴⁸ Thus, there is less need for shareholders to advocate for stakeholders. Management insulation from shareholder control, it is argued, is in fact favorable to stakeholders in that it “ties the hands” of shareholders ex ante to encourage stakeholders to make firm-specific investments without fear that shareholders will transfer value from the firm ex post.⁴⁹ These benefits may be lost if shareholders gain real control over management. This view also resonates with progressive corporate law scholars, such as Lawrence Mitchell, who see board control as a better safeguard of firm interests as a whole, and who fear that shareholder pressure for higher profits will keep management from giving proper attention to employees and other corporate stakeholders.⁵⁰ In short, shareholder empowerment might actually exacerbate market pressures toward single-minded profit generation, at the expense of stakeholder interests.

Other scholars note more pernicious dangers. They contend that powerful investors will use their power to exact concessions from other corporate constituencies (the “holdup” problem), siphon off firm value toward opportunistic shareholders or shareholder coalitions (“rent-seeking”), or align with management to the detriment of nonshareholders (“co-optation” or “gang up”).⁵¹ These concerns echo criticisms first

46. Henry G. Manne, *The “Corporate Democracy” Oxymoron*, WALL ST. J., Jan. 2, 2007, at A23.

47. See Bainbridge, *Limited Shareholder Voting Rights*, *supra* note 35, at n.89. See also Lipton & Rosenblum, *supra* note 35, at 82–85 (arguing that greater shareholder involvement will bog down the corporation in inefficient, value-reducing negotiations with various shareholder groups).

48. See, e.g., Blair & Stout, *supra* note 29, at 253 (arguing that “boards exist . . . to protect the enterprise-specific investments of *all* the members of the corporate “team,” including shareholders, managers, rank and file employees, and possibly other groups, such as creditors”). Lynn Stout suggests in her later work that she has no objection to shareholder advocacy of stakeholder interests, so long as it is not driven by an economic conflict of interest. See Anabtawi & Stout, *supra* note 17, at 1284 (explaining that directors are free to consider the interests of multiple stakeholders).

49. Blair & Stout, *supra* note 29, at 304–05. See also Bainbridge, *Director Primacy*, *supra* note 3, at 579 (arguing that “directors and shareholders would strike a bargain [in advance] in which directors pursue shareholder wealth maximization” but that such an approach “often redounds to the benefit of nonshareholder constituencies”).

50. See, e.g., Lawrence Mitchell, *The Board as a Path to Corporate Social Responsibility*, in *THE NEW CORPORATE ACCOUNTABILITY* 207, 283 (Doreen McBarnet et al., eds. 2007).

51. See Paul Rose, *Common Agency and the Public Corporation*, 64 VAND. L. REV. (forthcoming October 2010) (detailing the costs of activism by heterogeneous shareholders); Martin Gelter, *The Dark Side of*

raised in the 1990s about public pension funds’ susceptibility to political capture by “special interests” and the potential for their influence to be used to the detriment of other shareholders and of the corporation.⁵²

Assessing the strength of these competing concerns will require further empirical investigation as the regulatory changes reviewed above are implemented. In the meantime, it is clear that claims about the merits and limits of shareholder empowerment are entwined with the question of the proper space for stakeholders in corporate decision-making. Largely overlooked in these debates, however, is the possibility that shareholders may define their own long-term economic interests *in terms of* stakeholders. The “enlightened shareholder value” vision of the corporation described in Part IV is one such approach. It is also one which suggests new responses to some of the concerns surrounding shareholder power. Before considering this alternative vision and evidence of its emergence, this Article lays a foundation for that discussion by reviewing the position of stakeholders under prevailing corporate law rules.

III. STAKEHOLDERS UNDER CORPORATE LAW

Over the course of the past century, the famous debate between Adolph Berle and Merrick Dodd in the Harvard Law Review over the nature and purpose of the corporation has been traced and retraced in a pendulum swing between two fundamental positions. First is the shareholder-oriented view, that the corporation is formed from the nexus of private contracts (or is, alternatively, a private entity) whose primary purpose is to maximize shareholder wealth. Second is the stakeholder view, that the corporation has both public and private roles and must therefore be managed in the interests of a broader range of stakeholders, including employees, consumers, and even the public at large.⁵³

Shareholder Influence, 50 HARV. INT’L L.J. 129, 129 (2009) (arguing that “shareholder oligarchy” creates greater risks of shareholder “holdup” of employees and other nonshareholder groups, even as it creates better conditions for shareholder engagement); Iman Anabtawi, *Some Skepticism About Increasing Shareholder Power*, 53 UCLA L. REV. 561, 575–77, 589–90 (2006) (highlighting the dangers of rent-seeking behavior and shareholder empowerment in light of shareholders’ heterogenous non-economic interests); Anabtawi & Stout, *supra* note 17, at 1261 (stating that trends in shareholder activism “point to an inevitable increase in the risk of shareholder opportunism”); Lipton & Rosenblum, *supra* note 35, at 67 (“[T]here is serious doubt as to whether institutional shareholders, public pension funds, and labor unions—the parties most likely [to engage in shareholder activism]—are well-suited to [monitor directors]” because each “has duties to its own constituencies [and] its own agenda.”); Jennifer Hill, *Visions and Revisions of the Shareholder*, 48 AM. J. COMP. L. 39, 62–63 (2000) (stressing the threat to organized labor posed by alliances between management and powerful institutional shareholders).

52. See, e.g., Roberta Romano, *Public Pension Fund Activism in Corporate Governance Reconsidered*, 93 COLUM. L. REV. 795 (1993) (finding that “public pension funds face distinctive investment conflicts that limit the benefits of their activism”). As of March, 2011, new regulations issued by the SEC will prohibit “pay to play” practices by investment advisers in order to curtail efforts to win public pension fund business through political contributions. Political Contributions by Certain Investment Advisers, 75 Fed. Reg. 41,018 (July 14, 2010) (to be codified at 17 C.F.R. pt. 275). The new rules should address the primary concerns raised about public pension fund conflicts of interest. *Id.*

53. Adolf Berle, *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049, 1060–69 (1931); Merrick Dodd, *For Whom are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145, 1153–57 (1932). Berle emphasized the fiduciary duties of managers toward shareholder-beneficiaries, while Dodd argued for broader obligations to a wider set of constituencies, including employees, consumers, and the public at large. As has been frequently observed, their positions diverged largely because of what they saw as the core problems

Corporate law in most of the rest of the world follows a stakeholder approach,⁵⁴ while dominant understandings of the corporation's role and purpose in the United States remain decidedly shareholder-oriented.⁵⁵

The "standard shareholder-oriented model" of the corporation has generally been viewed to encompass essentially three elements: (i) the view that the corporate objective is to maximize shareholder wealth, as measured by the market value of the corporation's shares; (ii) the principle that control over the corporation lies ultimately with shareholders; and (iii) the principle that shareholders are the primary beneficiaries of judicially enforceable fiduciary duties owed by management and of special monitoring rights, such as voting rights and the right to bring derivative actions, that are generally not afforded to other corporate constituencies.⁵⁶

The first element, the shareholder wealth maximization norm, establishes both the "ends" of corporate decision-making and the decision-making rule for corporate managers (i.e., the "means")—namely, that managers advance the best interests of the corporation by acting exclusively in the economic interests of shareholders.⁵⁷ The second and third principles address the balance of power between shareholders and management, and between shareholders and stakeholders, respectively. Scholarly positions on these dimensions can be traced along the axes introduced by Bainbridge, as shown below.⁵⁸

confronting corporate law. See, e.g., Ronald Chen & Jon Hanson, *The Illusion of Law: The Legitimizing Schemas of Modern Policy and Corporate Law*, 103 MICH. L. REV. 1, 32–35 (2004) (explaining power dynamics between society and corporations). Berle was most concerned with agency problems resulting from the separation of ownership and control, while Dodd worried about the effects of unrestrained corporate power on nonshareholders. *Id.* at 34–35.

54. See, e.g., Sanford M. Jacoby, *Corporate Governance in Comparative Perspective: Prospects for Convergence*, 22 COMP. LAB. L. & POL'Y J. 5 (2000) (explaining the effects of globalization on corporate governance).

55. See, e.g., Chen & Hanson, *supra* note 53, at 32 (referring to shareholder primacy as the "macro script of corporate law"); Michael C. Jensen, *Value Maximization, Stakeholder Theory, and the Corporate Objective Function*, 14 J. APPL. CORP. FIN. 8, 8–9 (2001) (hailing the strong support for the shareholder primacy norm in "200 years of research in economics and finance"). For a history of shareholder primacy, see D. Gordon Smith, *The Shareholder Primacy Norm*, 23 J. CORP. L. 277 (1998) (explaining shareholder primacy norm and its limited application to ordinary business decisions).

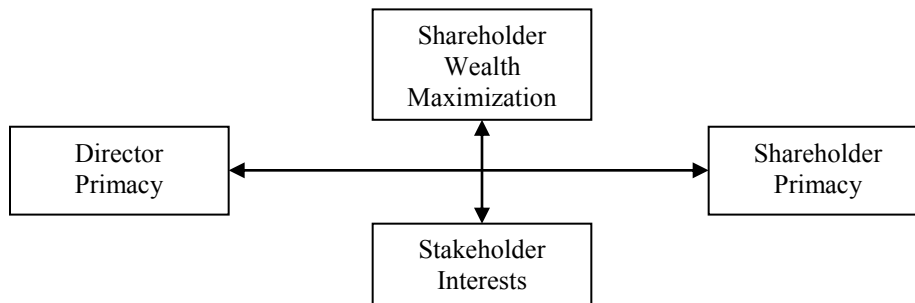
56. See Hansmann & Kraakman, *supra* note 14, at 440–43; Bainbridge, *Director Primacy*, *supra* note 3, at 573–74 (focusing on "the shareholder wealth maximization norm, . . . and the principle of ultimate shareholder control" but addressing the third principle, that shareholders are the beneficiaries of fiduciary duties and monitoring rights).

57. The classic case of *Dodge v. Ford Motor Co.*, which endorsed this proposition, states:

A business corporation is organized and carried on primarily for the profit of the stockholders The discretion of directors is to be exercised in the choice of means to attain that end, and does not extend to a change in the end itself, to the reduction of profits, or to the nondistribution of profits . . . in order to devote them to other purposes.

Dodge v. Ford Motor Co., 170 N.W. 668, 684 (Mich. 1919).

58. Bainbridge, *Director Primacy*, *supra* note 3, at 547–48.

Figure 1: The “Means” and “Ends” of Corporate Governance⁵⁹

In Figure 1, the vertical axis represents the range of positions with regard to the corporate purpose (the “ends”), and the horizontal axis represents views on the proper center of corporate decision-making power (the “means”). It should be noted that some ambiguity surrounds use of the term “shareholder primacy,” which can refer to both the shareholder wealth maximization norm (the vertical axis) *and* to the view that the balance of power in corporate governance should be set in favor of greater shareholder control (the horizontal axis).⁶⁰ Interestingly, with only limited exceptions, neither aspect of shareholder primacy is in fact mandated by corporate law.

A. Shareholder Wealth Maximization

Despite the divergent uses of the term “shareholder primacy,” it is most often equated simply with the view that the purpose of the corporation is to maximize shareholder wealth. In the oft-quoted words of Milton Friedman, “there is one and only one social responsibility of business—to . . . increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition, without deception or fraud.”⁶¹ By establishing the “ends” of corporate decision-making, the shareholder wealth maximization norm also sets a decision-making rule for corporate managers—namely that the best interests of the corporation are advanced when managers act exclusively in the economic interests of shareholders. Under shareholder primacy in its strongest form, attention to nonshareholders, corporate philanthropy, or any other “socially responsible” activity that is profit-reducing is generally impermissible, because such activities necessarily impair the company’s ability to achieve maximum shareholder profits. To the extent that these activities generate profits, at least in the long run, they are simply good business, nothing more.⁶²

59. *See id.* at 547–48.

60. For a more complete treatment of shareholder primacy and its rationales, see generally Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Cost and Ownership Structures*, 3 J. FIN. ECON. 305 (1976); Smith, *supra* note 55; Lynn Stout, *Bad and Not-So-Bad Arguments for Shareholder Primacy*, 75 S. CAL. L. REV. 1189 (2002).

61. MILTON FRIEDMAN, CAPITALISM AND FREEDOM 133 (1962). *See also* Milton Friedman, *The Social Responsibility of Business Is to Increase its Profits*, N.Y. TIMES MAG., Sept. 13, 1970, at 32, 126.

62. *See* FRIEDMAN, *supra* note 61, at 135 (stating that charitable contributions and other expenditures on “socially responsible” conduct are justified as a matter of corporate self-interest and should not be “cloaked” in the guise of social responsibility).

This is not to say that stakeholders have no place in a shareholder primacy world. Indeed, as Jill Fisch notes, “both Berle and Dodd distinguished the legal obligations of managers to shareholders from their obligations to other stakeholders but, at the same time, acknowledged the legitimacy of other stakeholder interests.”⁶³ Under the standard law and economics argument, the surest way to produce the greatest aggregate social welfare is to “make corporate managers strongly accountable to shareholder interests and, at least in direct terms, only to those interests.”⁶⁴ By focusing squarely on shareholder wealth maximization, businesses can best contribute to the public good by paying taxes, hiring employees, and providing goods and services.⁶⁵

In addition, law is part of Friedman’s “rules of the game” within which firms operate and which constrain the corporation’s freedom to pursue profit maximization.⁶⁶ Thus, it is generally argued that stakeholder interests matter very much, but are adequately (and best) protected and advanced outside of corporate law by separate bodies of regulation, such as labor, environmental, or consumer protection regulations, and by explicit private contracts, which are the proper tools to address social welfare, equity, and distributional concerns.⁶⁷

However, it is generally acknowledged that shareholder wealth maximization is itself a norm of corporate behavior, rather than a legal tenet.⁶⁸ Indeed, neither case law nor corporate statutes impose on directors and officers an obligation to maximize shareholder wealth. Even in Delaware, whose corporate code is less receptive to stakeholder interests than many other state corporate statutes, there is no requirement that management decision-making maximize shareholder wealth or even be justified solely in terms of shareholder interests.⁶⁹ Moreover, as interpreted by the Delaware courts, directors and officers have a fiduciary duty to act “in the best interests of the company,” not solely in the interests of shareholders.⁷⁰ Accordingly, courts will not second-guess

63. Jill E. Fisch, *Measuring Efficiency in Corporate Law: The Role of Shareholder Primacy*, 31 J. CORP. L. 637, 648 (2006).

64. Hansmaan & Kraakman, *supra* note 14, at 441. *See also* FRIEDMAN, *supra* note 61, at 133–34.

65. *See* Hansmann & Kraakman, *supra* note 14, at 441 (operating the corporate enterprise to benefit the whole).

66. *See* FRIEDMAN, *supra* note 61.

67. *See, e.g.*, FRANK H. EASTERBROOK & DANIEL R. FISCHER, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* (1991).

68. *See* Fisch, *supra* note 63, at 650 (noting that “commentators widely recognize that shareholder primacy functions more as a norm than an enforceable legal rule”). *See also* Smith, *supra* note 55, at 278 n.1. The Delaware Chancery Court stated in *Katz v. Oak Industries, Inc.*, 508 A.2d 873, 879 (Del. Ch. 1986) that “[i]t is the obligation of directors to attempt, within the law, to maximize the long-run interests of the corporation’s stockholders,” but later rulings have rejected this view. *See* *Paramount Communications, Inc. v. Time, Inc.*, 571 A.2d 1140, 1145, 1155 (Del. 1990) (holding squarely that the board is under no duty to maximize *short-term* shareholder value and emphasizing the board’s duty is to act in the *corporation’s* best interest and to select the appropriate timeframe for consideration).

69. *See* Fisch, *supra* note 63, at 652 (observing that Delaware’s corporate statute is noticeably silent “both with respect to the standard by which board decisions are to be evaluated, and with respect to the stakeholders whose interests may legitimately be taken into account”); *Id.* at n.88.

70. *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984), *overruled on other grounds by* *Brehm v. Eisner*, 746 A.2d 244, 254 (Del. 2000). Other cases articulate this duty as one owed to “the corporation and its shareholders,” though not to “shareholders” alone. *See, e.g.*, *Smith v. Van Gorkom*, 488 A.2d 858, 872 (Del. 1985), *overruled on other grounds by* *Gantler v. Stephens*, 965 A.2d 695, 713, n.54 (Del. 2009). The dominant view among corporate scholars is that little should be read into the emphasis on the interests of the

directors’ “business judgment” that is based on concerns about employees, communities, and other non-shareholder constituencies, absent any finding of a clear breach of fiduciary duty.⁷¹ In fact, the broad discretion afforded directors under the business judgment rule applies even to profit-sacrificing decisions that benefit nonshareholders.⁷²

To be sure, the Delaware Supreme Court in *Revlon* held that there is a narrow range of cases where the board is required to maximize share price to the exclusion of all other criteria or interests. Specifically, “concern for non-stockholder interests is inappropriate when an auction among active bidders is in progress, and the object no longer is to protect or maintain the corporate enterprise, but to sell it to the highest bidder.”⁷³ However, in *Paramount v. Time Warner*, the court subsequently limited *Revlon* to the narrow circumstance of that case, that is, where the board has decided to put the company up for sale. Outside of *Revlon* mode, “a board of directors . . . is not under any per se duty to maximize shareholder value,”⁷⁴ and directors are expressly permitted to consider the interests of “creditors, customers, employees, and perhaps even the community generally.”⁷⁵ Thus, even in the hostile takeover context directors may reject shareholder-wealth-maximizing bids in the interests of stakeholders so long as the decision can pass muster under a heightened change of control standard of review.⁷⁶

Beyond the general affirmations of director discretion outlined above, other aspects of current corporate law expressly permit decision-makers to preference stakeholder interests over shareholder wealth maximization. For example, the majority of states (Delaware not included) have adopted constituency statutes, which allow directors to consider the impact of corporate decisions on a broad range of stakeholders—not just on shareholders—and permit decisions “in the best interests of the corporation” even if they are not justified on the basis of shareholders’ economic interests.⁷⁷ State corporate statutes also uniformly authorize corporations to make charitable contributions without

“corporation” as independent from the interests of shareholders, since courts have assumed that the two are synonymous and since any distinction improperly “reifies” the corporation as an independent identity. *See* Smith, *supra* note 55, at 285 n.32.

71. The exercise of discretion by corporate management is further shielded by standard charter provisions that exculpate or indemnify directors and officers for breach of the duty of care. *See generally* Smith, *supra* note 55 (arguing that because of the expansive scope of the business judgment rule, the true role of shareholder primacy in corporate law has been highly over-rated).

72. *See* Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733, 763–76 (2005). The leading case on profit-sacrificing decisions is *Shlensky v. Wrigley*, 237 N.E.2d 776, 780 (Ill. App. Ct. 1968), where the court upheld the directors’ decision to permit only daytime use of the stadium, which favored community interests at the expense of shareholder profits.

73. *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986).

74. *Paramount Commc’ns, Inc. v. Time, Inc.*, 571 A.2d 1140, 1150 (Del. 1990) (upholding board rejection of takeover offer that was based on a desire to protect Time’s corporate culture).

75. *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 955 (Del. 1985).

76. *See id.* *Unocal* introduced an intermediate standard of review in change of control transactions, requiring the board to show that their defensive action was a proportionate response to a reasonably perceived threat to the corporation. *Id.*

77. *See, e.g.*, IND. CODE § 23-1-35-1 (2010). These statutes were adopted in response to the hostile takeover wave of the 1980s and early 1990s. In practice, courts have relied on them only rarely since the business judgment rule and other anti-takeover statutes already protect directors who reject takeover bids out of concern for other stakeholders. Brett H. McDonnell, *Corporate Constituency Statutes and Employee Governance*, 30 WM. MITCHELL L. REV. 1227, 1231–32 (2004).

any showing that the contribution will improve profitability.⁷⁸

B. Control of the Firm

With regard to control rights in the firm (the horizontal axis), American corporate law rules are in fact predominantly *director*-centric. As then-Chancellor Allen once put it, the law “seems to have ringingly endorsed a managerialist or entity orientation,” rather than shareholder-centric control rules.⁷⁹ Indeed, both the Model Business Corporation Act and the corporate code in Delaware, the jurisdiction of choice for most publicly traded companies incorporated in the United States, confer upon the board of directors the authority and responsibility to manage the business and affairs of the corporation.⁸⁰ The expanse of the business judgment rule makes this authority quite broad.⁸¹

These director-centric rules are in fact quite compatible with a stakeholder orientation, as Professors Blair and Stout have demonstrated in their work on a “team production” theory of the firm, in which the public corporation depends upon the firm-specific investments of numerous stakeholders, including shareholders, employees, creditors, and communities.⁸² In the team-production model, these diverse interests are mediated by the board of directors in order to maximize the value of the firm to all stakeholders.⁸³ With recent trends expanding shareholder influence, American corporate governance appears to be moving toward a model of corporate control where influence over corporate decision-making is shared by shareholders and corporate boards. Nonetheless, the balance remains weighted toward director primacy and gives corporate directors wide latitude to consider, or even preference, the interests of nonshareholders.

C. Shareholder Preeminence

However, state corporate laws—as a rule—generally do not give nonshareholders any means of *directly* influencing corporate affairs, nor do they mandate management attention to stakeholder interests. In particular, the rights of shareholders to elect directors, vote on major corporate transactions, ratify interested transactions, submit

78. See, e.g., *Kahn v. Sullivan*, 594 A.2d 48, 63 (Del. 1991) (interpreting DEL. CODE ANN. tit. 8 § 122(9) (2010), the Delaware authority for corporate charitable contributions, to be limited only by a reasonableness test).

79. William T. Allen, *Our Schizophrenic Conception of the Business Corporation*, 14 CARDOZO L. REV. 261, 279 (1992).

80. MODEL BUS. CORP. ACT § 8.01(b) (4th ed. 2008) (“All corporate powers shall be exercised by or under the authority of the board of directors of the corporation, and the business and affairs of the corporation shall be managed under the direction, and subject to the oversight, of its board of directors” See also DEL. CODE ANN. tit. 8 § 141(a) (2009) (“The business and affairs of every corporation . . . shall be managed by or under the direction of a board of directors”). Lynn Stout also points out that the default rules giving greater discretion to directors also appear to be the initial rules preferred by investors themselves at the IPO stage. See Lynn A. Stout, *New Thinking on “Shareholder Primacy”* 16 (Jan. 10, 2005) (unpublished manuscript), <http://cdn.law.ucla.edu/SiteCollectionDocuments/ucla-sloan%20foundation%20conference/new%20thinking%20on%20shareholder%20primacy.pdf> (surveying the literature and calling the default rules and these findings on investor preferences the “twin anomalies” of director primacy in U.S. law).

81. The broad scope of the business judgment rule continues to be reaffirmed by the courts. See, e.g., *infra* notes 173–74 and accompanying text (discussing *In re Citigroup* and *In re Caremark*).

82. See Blair & Stout, *supra* note 29.

83. See generally *id.*

proposals for inclusion in the corporate proxy, sue derivatively and benefit from court-enforced director and officer fiduciary duties, are—with few exceptions—not extended to other corporate stakeholders.⁸⁴ Giving monitoring and enforcement power to shareholders makes corporate managers directly accountable only to shareholders, an arrangement deemed normatively optimal for reasons discussed further in Part V.⁸⁵

Still, the fact that shareholders alone are the primary beneficiaries of these rights need not be viewed as a legal requirement that management attend only to shareholders’ (economic) interests. Even assuming that shareholders as a class will prioritize wealth maximization, corporate law may grant monitoring and oversight rights to shareholders because they are in the best position to oversee management for the benefit of the firm as a whole.⁸⁶ Thus, established corporate governance structures that preference shareholders can be coherently explained from both a shareholder primacy and a stakeholder-oriented standpoint.

IV. DEFINING AND DRIVING ENLIGHTENED SHAREHOLDER VALUE: PATHWAYS BEYOND THE SHAREHOLDER–STAKEHOLDER DIVIDE

As we have seen, cross-currents of the shareholder-stakeholder debate lie beneath some of the core objections surrounding increased shareholder power. We have also seen that corporate law does not prevent, and in fact expressly permits, directors and officers of public corporations to take the interests of nonshareholders into account. This Part introduces “enlightened shareholder value” as an alternative vision of the corporate purpose and presents evidence that it is being embraced by a growing number of influential institutional investors. Part V draws on this foundation to assess enlightened shareholder value as a corporate decision rule and explore the response it offers to the stakeholder “problems” that have animated much of the controversy over shareholder empowerment.

A. Enlightened Shareholder Value Under the U.K. Companies Act

American corporate law scholars and policy makers have not infrequently drawn inspiration from regulatory innovations in the United Kingdom. Indeed, the U.K. experience has served as a source for some of Lucian Bebchuk’s recommendations in favor of increased shareholder voice.⁸⁷ This comparative approach has much to recommend it, since the United States and the U.K. share a common legal heritage and because their markets share important similarities—both have been historically

84. Progressive scholars have argued that there is insufficient justification to limit these preferential rights to shareholders. *See, e.g.*, KENT GREENFIELD, *THE FAILURE OF CORPORATE LAW* 41–71 (2006) (presenting justifications for the extension of monitoring and enforcement rights to workers); Mitchell, *supra* note 50. However, current Delaware case law does not recognize any fiduciary obligations to nonshareholders. Even when the corporation is approaching insolvency, creditors have standing to sue derivatively but are owed no direct fiduciary duties. *See* N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla, 930 A.2d 92, 103 (Del. 2007).

85. *See infra* notes 213–14, 224 and accompanying text (discussing supporting rationales grounded in economic efficiency and contractual theories of the corporation).

86. *See* Blair & Stout, *supra* note 29, at 312–14 (arguing that share price offers a proxy for firm value, albeit an imperfect one, on the assumption that shareholders will vote largely to maximize wealth).

87. *See* Bebchuk, *Shareholder Power*, *supra* note 30, at 847–50.

characterized by a base of dispersed investors, in contrast to Japan and Europe, where family-owned companies and concentrated ownership structures dominated by banks and conglomerates predominate.⁸⁸ Like the United States, corporate governance in the United Kingdom has historically been grounded on shareholder primacy. However, in 2006, when the United Kingdom enacted its new Companies Act, it took a small step in the direction of the European stakeholder model by introducing an “enlightened shareholder value” paradigm of corporate governance that merges elements of the shareholder primacy and stakeholder models.⁸⁹

The core of the enlightened shareholder value principle is embodied in Section 172 of the Companies Act, which defines the fiduciary duties of corporate directors as follows:

[A] director . . . must act . . . in good faith . . . to promote the success of the company for the benefit of *its members as a whole, and in doing so have regard to . . . the likely consequences of any decision in the long term; the interest of the company’s employees; the need to foster the company’s business relationships with suppliers, customers and others; the impact of the company’s operations on the community and the environment; the desirability of the company maintaining a reputation for high standards of business conduct; and the need to act fairly as between members of the company.*⁹⁰

As under prior law, shareholders monitor and enforce these duties through litigation.⁹¹

The Act also requires listed companies to recognize and report on stakeholder matters as part of providing comprehensive disclosures to investors.⁹² Specifically, the mandatory directors’ report, a business review of both financial and non-financial performance indicators, must include either information about the company’s environmental impact, employees, social and community issues, and “essential” contractual arrangements, *or* a statement detailing which type of information is not being provided.⁹³ These disclosures are required unless the information is not “necessary for an understanding of . . . the company’s business.”⁹⁴ Per Section 417(2) of the Companies Act, this report explicitly intends to permit members to evaluate directors’ compliance

88. See Jacoby, *supra* note 54, at 5 (surveying global corporate governance practice).

89. For the legislative history of the U.K. reforms, see generally, Gordon L. Clark & Eric R. W. Knight, *Implications of the U.K. Companies Act 2006 for Institutional Investors and the Market for Corporate Social Responsibility*, 11 U. PA. J. BUS. & EMP. L. 259 (2009); Williams & Conley, *supra* note 7, at 495, 499–523.

90. U.K. Companies Act, 2006, c. 46 § 172 (Eng.) [hereinafter U.K. Companies Act] (emphasis added).

91. *Id.* at pt. 11 (providing for member (i.e., shareholder) litigation rights). The limited case law applying section 172 has simply confirmed that it is to be interpreted in accordance with existing common law rules, equitable principles, and existing laws that require directors to give priority to the interests of creditors in certain instances. *Id.* § 170. See Andrew Keay, *Moving Towards Stakeholderism? Constituency Statutes, Enlightened Shareholder Value, and All That: Much Ado About Little?*, 21–22 (Jan. 2010) (unpublished manuscript) (on file with author).

92. U.K. Companies Act, *supra* note 90, c. 46 § 417.

93. *Id.*

94. *Id.* § 417(2). These provisions represent a much watered-down version of the mandatory social reporting requirements that were initially introduced in the United Kingdom in 2005 for the largest public companies as the Operating and Financial Review (OFR). The OFR was later abolished and ultimately replaced by Section 417 of the Companies Act. For a description of the OFR, see Williams & Conley, *supra* note 7, at 516–22. For the Companies Act version, see generally Clark & Knight, *supra* note 89.

with their fiduciary duties under Section 172.⁹⁵

Nonetheless, under the Companies Act directors remain directly accountable only to shareholders. The Act maintains the (unitary) board of directors as the decision-making authority of the firm, with space for some degree of member (i.e., shareholder) control. It also rejects the European Union’s approach to takeover law and labor issues, such as German codetermination or other requirements that labor be represented on corporate boards.⁹⁶ Consistent with prior law, the Companies Act also places shareholders as the sole corporate constituency permitted to elect directors, bring a derivative suit, and authorize interested transactions.⁹⁷

The central elements of this “enlightened shareholder value” model are (i) an explicit focus on long-term shareholder value as the goal of the corporation; (ii) a requirement that corporate directors and officers consider the effects of their decisions on “extended stakeholder constituencies,” financial and non-financial, that are referenced in Section 172; and (iii) a rejection of changes to the corporate decision-maker (i.e., the board with shareholder oversight) or the rules that give shareholders monitoring and enforcement rights not afforded to other stakeholders. To no small degree, then, “enlightened shareholder value” looks like the standard Anglo–American corporate governance model. As its name suggests it is grounded squarely within a shareholder-primacy paradigm that emphasizes economic efficiency and returns on shareholder investments. It might also be argued that an ESV approach differs little from the current state of affairs under state nonshareholder constituency statutes, which permit corporate management to consider the interests of the various stakeholders contemplated by the U.K. Companies Act reforms.⁹⁸

But in contrast to both traditional shareholder primacy (and the approach of most constituency statutes), the U.K. reforms *require* boards to justify their decisions in terms of stakeholder interests and to disclose risks impacting stakeholders. By doing so, the United Kingdom endorses a multi-stakeholder decision-making rule and makes management at least indirectly accountable to stakeholders. In short, the goal of the U.K. approach is to “maintain [corporations’] financial accountability to a constituency of dispersed, independent shareholders while *simultaneously* using market forces to nudge companies in the direction of greater social responsibility.”⁹⁹

To date, there has been no movement in the United States to follow the United Kingdom and mandate “enlightened shareholder value” through state or federal corporate legislation. Indeed, there are many reasons why such a stakeholder-oriented regulatory shift is unlikely. First, of the states that enacted constituency statutes, only one makes consideration of stakeholder interests mandatory.¹⁰⁰ Key differences between the

95. U.K. Companies Act, *supra* note 90, c. 46 §§ 172, 417(2).

96. Williams & Conley, *supra* note 7, at 550.

97. *See, e.g.*, U.K. Companies Act, *supra* note 90, at arts. 188–223, 239 (listing the various interested transactions requiring member approval); U.K. Companies Act, *supra* note 90, at pt.11 (permitting derivative claims by members).

98. *See supra* note 77 and accompanying text.

99. Williams & Conley, *supra* note 7, at 500 (emphasis added).

100. Connecticut is the sole state where consideration of stakeholder interests is mandatory. *See* CONN. GEN. STAT. § 33-756(d) (2009) (corporations “shall consider . . . (3) the interests of the corporation’s employees, customers, creditors and suppliers, and (4) community and societal considerations”). The literature defending and attacking constituency statutes is too vast to cite fully here. *See, e.g.*, Stephen Bainbridge,

dominant institutional investors in the United Kingdom (pension funds/insurers) and the United States (mutual funds), as well as the two countries' regulatory environments, make stakeholder-oriented corporate reform less likely in the United States.¹⁰¹ But given the strong and growing shareholder-orientation of the U.S. market, it is more likely that enlightened shareholder value will instead make inroads through shifts in the power and priorities of shareholders themselves.

B. Investor-Driven Enlightened Shareholder Value

More than two decades of scholarship has considered (and largely dismissed) the possibility that large institutional investors and other shareholders could drive greater corporate accountability to shareholders, much less bring about a new era of corporate social responsibility.¹⁰² However, the rise of shareholder democracy, the growing market power of institutional investors, and changes in the economic and regulatory climate all give cause for a second look. Indeed, as discussed below, many influential institutional investors now view attention to stakeholder concerns, such as environmental protection, labor and human rights, and related corporate governance reforms, as key to long-term financial gain. Interestingly, these developments come at a time when institutional investors are also well-positioned to bring an ESV vision into mainstream U.S. corporate practice.

This subpart considers indicators of these trends, as well as the avenues through which these investors are seeking to advance greater stakeholder-orientation among investment intermediaries and in corporate practice.¹⁰³ The purpose here is not to demonstrate that shareholders are better positioned to advance stakeholder interests than, for example, boards or stakeholders themselves. Rather, the aim is to show first that investors are both able and willing to do so, and for reasons that are in fact quite conventional—the prospect of higher long-term returns and more comprehensive information on investment risks.

1. Expressions of Enlightened Shareholder Value: ESG Risk Management & the United Nations Principles for Responsible Investment

One of the most important expressions of an emerging enlightened shareholder value paradigm is growing attention to stakeholder issues as a critical element of firm and portfolio risk management. Much of the current energy in this direction focuses on developing tools to help firms, investors, and fund managers identify, measure, and

Interpreting Nonshareholder Constituency Statutes, 19 PEPP. L. REV. 971, 971–96 (1992) (summarizing the literature).

101. See Williams & Conley, *supra* note 7, at 529 (speculating that movements toward shareholder power might in future give rise to the phenomenon explored here—that shareholders might “define *shareholder* value to include *stakeholder* concerns”) (emphasis in original). See also *supra* notes 18–23 (regarding institutional investor characteristics). Although some of these gaps are narrowing, the British government remains much more strongly committed to advancing corporate social responsibility than U.S. state and federal governments; societal support for these goals is also arguably still stronger in the United Kingdom.

102. See *supra* note 16 and accompanying text.

103. Alternative terms have been suggested for what I refer to here as “enlightened shareholder value.” See, e.g., Hess, *supra* note 12 (proposing sustainable “long-term responsible investment” or simply “LTRI,” and noting that no uniform terminology has yet emerged).

manage "environmental, social, and governance" (ESG) risks in order to improve the quality of information available to investors and potentially increase overall portfolio returns and firm competitiveness.¹⁰⁴

The scope of ESG risks is not limited to "environmental, social, and governance" measures, but extends to all "extra-financial" fundamentals that can impact financial performance, such as climate change, corporate governance, employment standards, human resources, executive compensation, environmental impact, and reputational risk.¹⁰⁵ Such issues are not typically reflected in standard accounting measures because they tend to be qualitative in nature and are related to externalities not well captured by standard accounting measures. ESG measures are also generally forward-looking and/or have effect largely in the medium- to long-term. Some ESG risks, particularly environmental risks, are increasingly material for many companies because they are the subject of public concern or are areas of heightened regulatory attention.¹⁰⁶ Although the precise issues and measures that matter to particular investors or firms may vary, generally speaking, ESG investment strategies require investors, financial intermediaries, and corporate management to account for the effects of corporate operations on a wide range of nonshareholder constituencies.

Among the broadest efforts to mobilize mainstream institutional investors around an ESG-oriented approach are the United Nations Principles for Responsible Investment (PRI). The PRI was developed by the joint efforts of 20 leading institutional investors under the auspices of the United Nations Environmental Programme Finance Initiative (UNEP FI) and the United Nations Global Compact in 2006.¹⁰⁷ Institutional investor signatories voluntarily commit to support and implement the following six core principles in a manner consistent with their fiduciary duties toward their beneficiaries: (i) incorporate ESG issues into investment analysis and decision-making; (ii) adopt an active ownership strategy and engage portfolio companies around ESG issues (iii) seek appropriate ESG disclosures from portfolio companies; (iv) promote acceptance and implementation of the PRI among service providers and others within the investment industry; (v) collaborate with other signatories to implement the PRI; and (vi) disclose to beneficiaries and the public how ESG issues are integrated within investment practices, policies toward service providers, and active ownership activities.¹⁰⁸

The primary goal of the PRI is to channel institutional investor power toward promoting the integration of ESG issues within internal investment practices, by financial intermediaries, and down the investment chain to portfolio companies.¹⁰⁹ Secondly, the PRI creates a framework for institutional investor accountability to industry peers and

104. "Social risks" are risks arising from practices affecting the workforce, such as liability risk, or reputational risk associated from poor employment practices.

105. See, e.g., 2008 ESG Background Report, *infra* note 144 (describing scope of various ESG measures).

106. See, e.g., *What are EFIs?*, ENHANCED ANALYTICS INITIATIVE, <http://www.enhanced-analytics.com> (follow "What is EAI?"; then follow "What are EFIs?") (last visited Sept. 1, 2009) [hereinafter ENHANCED ANALYTICS INITIATIVE, *EFIs*] (explaining Extra-Financial Issues (EFIs)).

107. The PRI initiative is governed by an elected Board of 11 representatives from asset owner signatory organizations and two representatives from the United Nations. The Secretariat reports to the PRI Board. See *The Principles for Responsible Investment*, PRINCIPLES FOR RESPONSIBLE INVESTMENT INITIATIVE, <http://www.unpri.org/about/> (last visited July 21, 2010) [hereinafter, PRI].

108. *Id.*

109. *Id.*

to the public for progress toward these goals. The PRI is significant because its intended scope is not limited to isolated issues, portfolio companies, or investors, but rather extends horizontally across the investment industry, vertically throughout the investment (and ultimately, supply) chain, and broadly across a range of corporate social responsibility and stakeholder concerns.

2. *The ESG Rationale*

Historically, stakeholder-oriented investment has been identified almost exclusively with “socially responsible investment” (SRI) strategies that identify particular industries or firms to exclude from (or include in) an investment portfolio based on certain ethical or “values-based” screens and may prioritize ethical, religious, social, and/or environmental concerns equally or above financial risk and return.¹¹⁰ Many institutional investors shy away from social screening because of regulatory diversification mandates,¹¹¹ because of the perception that ethical or moral investment criteria cannot be adopted by fund fiduciaries,¹¹² or because of the belief that a restrictive investment approach will result in systematically below-market returns and overall higher risk exposure.¹¹³ The limits of the screening model are among the key factors that have kept SRI from being embraced by the mainstream investment community and from having a deeper impact on corporate practice.¹¹⁴

ESG-oriented investing and activism, however, is grounded on traditional economic rationales. The two primary rationales that together form the “business case” for this form of “responsible investment” are the prospect of higher long-term returns, and improved firm-level risk management and portfolio-level risk analysis. For example, the PRI affirms that a focus on ESG matters “may better align investors with the broader objectives of society,” but its fundamental rationale is solidly grounded in shareholder primacy—namely, that “consideration of [ESG] issues is part of delivering superior risk-adjusted returns” to investors over the long run.¹¹⁵ Given the potentially controversial nature of an effort to define shareholder value explicitly with reference to stakeholders, it is important to unpack the relationship between ESG risk management and financial

110. This definition is adapted from Lloyd Kurtz, *Socially Responsible Investment and Shareholder Activism*, in *THE OXFORD HANDBOOK OF CORPORATE SOCIAL RESPONSIBILITY* 250, 250 (Andrew Crane et al., eds., 2008).

111. For a survey of these limits, see *id.* at n. 30.

112. Many pension fund managers are of the view that ERISA’s prudent investor standard requires a unitary focus on maximizing returns to beneficiaries and thus prevents them from basing investment decisions on ethical or other non-financial factors. See RONALD B. DAVIS, *DEMOCRATIZING PENSION FUNDS: CORPORATE GOVERNANCE AND ACCOUNTABILITY* 56–62 (2008) (discussing pension fund fiduciary duties).

113. There is some evidence that over the long term SRI screened funds may perform at least as well as (but not better than) unscreened peers; however, there is also some evidence based on SRI indices that SRI investments may not exhibit a lower risk profile than comparable non-SRI investments. See Kurtz, *supra* note 110, at 269–71.

114. Even the term “SRI” prompts a negative knee-jerk reaction from many mainstream institutional investors. See Hess, *supra* note 12, at 229–30 (citing survey results); John M. Conley & Cynthia A. Williams, *Engage, Embed, and Embellish: Theory Versus Practice in the Corporate Social Responsibility Movement*, 31 *J. CORP. L.* 1 (2005) (citing interview results).

115. FAQs, PRINCIPLES FOR RESPONSIBLE INVESTMENT INITIATIVE, <http://www.unpri.org/faqs/> (last visited Sept. 13, 2010).

performance.

a. Firm-Level Risk Management and Financial Performance

Considering first the firm-level perspective, the rationale is that management failure to understand and respond to ESG risks can hurt the company’s long-term financial performance, while monitoring ESG issues can help management identify such risks as well as new opportunities to generate long-term shareholder wealth.¹¹⁶ Reducing firm-level risk can confer direct benefits on managers, employees, creditors, and other stakeholders who have made firm-specific investments in the company and thus have vested interests in the firm’s survival. Better ESG risk management may also benefit the firm by lowering the cost of capital.¹¹⁷ If attention to ESG matters translates into a broader commitment to corporate social responsibility, it may also produce economic benefits by improving brand loyalty, employee retention and motivation, resource allocation, and overall competitive advantage.¹¹⁸

A number of studies by the United Nations Environmental Programme Finance Initiative and other researchers testing these claims have found either a neutral effect or a positive correlation between ESG factors and corporate financial performance (CFP).¹¹⁹ While further research is needed, these early results lend support to the substantial empirical literature finding, on balance, that there is weak but positive correlation between corporate social performance (CSP) and CFP.¹²⁰

116. See, e.g., ENHANCED ANALYTICS INITIATIVE, *EFIs*, *supra* note 106 (stating that members of Enhanced Analytics Initiative, a collaboration between asset managers and ESG researchers, “believe good management of extra-financial performance can reduce risk and may, in some circumstances, deliver added value”). See also *infra* notes 119–20 (discussing the materiality of ESG measures to corporate financial performance).

117. See Mark Sharfman & Chitru S. Fernando, *Environmental Risk Management and the Cost of Capital*, 29 STRATEGIC MGMT. J. 569 (2008) (presenting empirical evidence that environmental risk management reduces the cost of equity capital and allows firms to more easily obtain debt financing).

118. See, e.g., Michael E. Porter & Mark R. Kramer, *Strategy & Society: The Link Between Competitive Advantage and Corporate Social Responsibility*, 84 HARV. BUS. REV. 78 (Dec. 2006) (discussing the emergence of CSR as a priority for business leaders).

119. The UNEP Finance Initiative has published a series of reports on the materiality of ESG measures to equity pricing. See, e.g., *The Materiality of Social, Environmental and Corporate Governance Issues to Equity Pricing*, UNEP FINANCE INITIATIVE (June 2004), available at http://www.unepfi.org/fileadmin/documents/amwg_materiality_equity_pricing_report_2004.pdf; *Show Me the Money: Linking Environmental, Social and Governance Issues to Company Value*, UNEP FINANCE INITIATIVE (2006), available at http://www.unepfi.org/fileadmin/documents/show_me_the_money.pdf.

120. See David P. Baron et al., *The Economics and Politics of Corporate Social Performance* 4 (Stan. U. Graduate Sch. of Bus., Working Paper No. 1993, 2009), available at <http://ssrn.com/abstract=1202390> (surveying the empirical literature). See also Marc Orlitzky, *Corporate Social Performance and Financial Performance: A Research Synthesis*, in THE OXFORD HANDBOOK OF CORPORATE SOCIAL RESPONSIBILITY (Andrew Crane et al., eds., 2008) (conducting a meta-analysis of the literature and concluding that “there is a positive, but highly variable, relationship between [the two] and that they are mutually reinforcing and positively correlated). But see Amann et al., *supra* note 1, at 343–44 (concluding from a similar meta-analysis that “numerous” empirical studies on the links between corporate social performance and corporate financial performance have been done “without arriving at truly proven results one way or the other”).

b. Portfolio-Level Risk Management and Financial Performance

At the portfolio level, the argument that better ESG risk assessment will improve risk-adjusted returns across a portfolio is more complex. First, ESG risks can be either systematic (i.e., undiversifiable) risks affecting the market as a whole (measured by *beta*) or unsystematic, diversifiable risks that are firm-specific.¹²¹ Systematic risks include the risk of regulatory, socioeconomic, or political changes, such as a change in the rate of inflation or the gross national product (GNP).¹²² Examples of firm-specific (i.e., diversifiable) risk, on the other hand, might include risk related to potential product liability claims or a change in corporate management. According to the standard capital asset pricing model (CAPM), to the extent that investors are able to diversify away firm-specific risk (even if they fail to do so), they are not compensated with a higher risk premium on the asset.¹²³ Thus, there should be no economic gain to the investor from reducing firm-specific risk.

However, modern portfolio theory offers an explanation for why large institutional investors might want to reduce even firm-specific risk—namely, that unique, firm-specific risks, such as the risk created by poor environmental practices, are in fact internalized by the portfolio investor, since the cost of the harms, or negative externalities, produced by one portfolio firm may in fact be borne by other portfolio firms.¹²⁴ These costs might arise directly—for example, if environmental harms impact real estate owned or insured by another entity in the portfolio—or may be indirect costs assessed against the economy as a whole—for example, higher tax rates imposed in a given locality to cover environmental cleanup.¹²⁵ Therefore, highly diversified investors have a direct incentive to seek more comprehensive information on the externalities produced by portfolio firms and to respond to such information through exit or engagement.

Moreover, some highly diversified investors, including ESG's main proponents, are so-called "universal owners," a term which refers to public and private pension funds, mutual funds, labor union funds and other large institutional investors that are diversified to the point that they are in essence invested across the entire economy.¹²⁶ Because of the breadth of their holdings, such investors have particular incentives to attend to the long-term health of the broader economy.¹²⁷ They may also be more predisposed to take into account issues, such as the environment, labor practices, health care, and anti-competitive behavior, that impact entire industries and the economy as a whole.¹²⁸

121. STEPHEN A. ROSS ET AL., CORPORATE FINANCE 347–48 (9th ed. 2010).

122. *Id.*

123. *Id.* at 347–61.

124. See HAWLEY & WILLIAMS, *supra* note 18, at 5–18, 98–99 (noting that such investors will for similar reasons have interest in encouraging firms to produce *positive* externalities, such as through research and development).

125. These examples are drawn from HAWLEY & WILLIAMS, *supra* note 18, at 4–5.

126. According to Hawley and Williams, a "universal owner" is "an institutional owner whose holdings are highly diversified and, typically, held long term," such that they essentially represent a cross-section of the entire economy. *Id.* at 3.

127. See *id.* at 3–18; ROBERT A.G. MONKS & NELL MINOW, WATCHING THE WATCHERS: CORPORATE GOVERNANCE FOR THE 21ST CENTURY 262–63 (1996).

128. *Id.*

One of the most important reasons why prominent institutional investors and financial intermediaries are behind much of the movement to account for ESG risks is that more comprehensive information regarding firm-level ESG risks might increase the quantity and quality of non-financial information available to the markets and better enable diversified owners to more accurately structure their portfolios in accordance with their risk preferences. Institutional investors rely strongly on the information reflected in market prices and on financial agents’ responses to those prices.¹²⁹ If, as is now widely recognized, there are limits to market efficiency,¹³⁰ then the market may only imperfectly account for risk.

Moreover since comparable, verifiable information related to certain stakeholder interests—such as environmental and social matters—is essential if markets are to accurately evaluate firms’ market prices, its absence means that the entire market (and thus the investors’ portfolio) is subject to systemic distortions.¹³¹ If this is so, incorporating ESG factors into investment analysis may offer a way for investors to achieve higher risk-adjusted returns (measured by *alpha*)—that is, to “beat the market” by exploiting these informational inefficiencies, at least until other investors trade on the same information and the market adjusts. Ultimately, the creation and dissemination of data on ESG and non-financial corporate performance measures should improve the efficiency and accuracy of pricing signals in the market as a whole, although again reducing the likelihood of unique gains to ESG-informed investors. A corporation can realize these informational benefits even if the ultimate allocation of portfolio funds remains unchanged.

As with firm-level analyses, empirical studies to date have generally found that incorporation of ESG measures into portfolio allocation decisions has either a neutral or positive effect on portfolio returns relative to standard benchmarks.¹³² These studies lend some support to the view that investors may reap financial rewards (i.e., *alpha*) relative to the market by being the “first movers” investing with the benefit of ESG-related information.¹³³ If borne out by further research, such findings may bolster the claim that

129. Clark & Knight, *supra* note 89, at 269.

130. Discussion of market efficiency and its limits are standard in any corporate finance textbook. *See, e.g.,* ROSS ET AL., *supra* note 121, at 428–66. *See also* Lynn A. Stout, *The Mechanisms of Market Inefficiency: An Introduction to the New Finance*, 28 J. CORP. L. 635 (2003) (exploring alternatives to the ECMH).

131. Clark & Knight, *supra* note 89, at 269. *See also* Alex Edmans, Does the Stock Market Fully Value Intangibles? Employee Satisfaction and Equity Prices (June 26, 2010) (unpublished manuscript) (on file with author), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=985735 (demonstrating that the stock market does not fully value certain intangibles, such as employee satisfaction).

132. *See* M. Scott Donald & Nicholas Taylor, *Does “Sustainable” Investment Compromise the Fiduciary Duties of Superannuation Trustees?*, 36 AUSTL. BUS. L. REV. 47 (2008) (presenting a meta-analysis of over 40 academic studies on the integration of ESG factors and portfolio performance); U.N. Env’t. Prog. Fin. Initiative, Asses Mgmt. Working Grp. & Mercer, *Demystifying Responsible Investment Performance*, U.N. ENV’T. PROG. FIN. INITIATIVE (Oct. 2007), http://www.unepfi.org/fileadmin/documents/Demystifying_Responsible_Investment_Performance_01.pdf (reviewing 20 peer-reviewed academic studies of the effect of ESG factors on portfolio performance, half of which found a positive effect, seven a neutral effect, and three a negative effect); Jeroen Derwall et al., *The Eco-Efficiency Premium Puzzle*, 61 FIN. ANALYSTS J. 51 (2005) (finding that portfolios invested in environmentally efficient firms from 1995 to 2003 produced higher returns than firms with poor environmental ratings).

133. *See, e.g.,* GOLDMAN SACHS GLOBAL INVEST. RESEARCH, *Introducing GS SUSTAIN 6–10* (June 22, 2007), available at www.unglobalcompact.org/docs/summit2007/S1_GOLDMAN_Ling.pdf (finding no

inclusion of ESG measures in investment analysis is in line with the fiduciary duties of public pension funds and other major institutional investors.

3. Implementation & Diffusion

Despite the rise of shareholder empowerment, questions remain about whether public pension funds and other institutional investors will use their power to promote long-term “responsible investing” or ESG-oriented investing strategies, and if so, whether their voices will outweigh counter-pressure from investors who do not share this view. Indeed, it is widely recognized that for much of the past decade, market pressures and the behavior of institutional investors themselves encouraged aggressive risk-taking and an over-emphasis on short-term profits.¹³⁴ Past studies also suggest that given the reality of high portfolio turnover and the costs of activism, the vast majority of public pension funds and other institutional investors will remain rationally apathetic and leave the challenge of translating enlightened shareholder value into corporate practice in the hands of a relatively limited number of institutional activists.¹³⁵ Even if these barriers are overcome, “enlightened” investor activism might simply create more sustainability “talk” and less “walk” among public companies.¹³⁶

However, for a new stakeholder-oriented norm to compete with traditional shareholder wealth maximization, it is not necessary that all market participants sign on, so long as market leaders (both investors and corporate management) have a shared interest in promoting change. Indeed, many of the successes of investor activism highlighted below are the result of a limited number of investors focusing their efforts on select targets, generally the largest, most visible public companies, in order to spur market-wide changes.¹³⁷ As the following discussion shows, enlightened shareholder value principles are already being adopted by leading institutional investors and other

correlation between ESG performance and stock market performance, but that incorporating ESG factors into long-term industry and returns-based analysis identified companies that outperformed relevant indices by 25% between 2005 and 2007 and outperformed peers by 75% over the same period). It should be noted that the findings were based on Goldman Sachs’ proprietary ESG analytics.

134. See ASPEN INSTITUTE, *OVERCOMING SHORT-TERMISM: A CALL FOR A MORE RESPONSIBLE APPROACH TO INVESTMENT AND BUSINESS MANAGEMENT* (Sept. 9, 2009), available at http://www.aspeninstitute.org/sites/default/files/content/docs/business%20and%20society%20program/overcome_short_state0909.pdf. Even public pension funds, those often viewed most likely to promote corporate accountability, fueled short-termism by shifting more holdings toward higher-risk, higher-return investments, such as private equity and hedge funds, and by compensating fund managers on the basis of short-term portfolio returns. See Hess, *supra* note 12, at 245–46. See also Robert C. Illig, *The Promise of Hedge Fund Governance: How Incentive Compensation Can Enhance Institutional Investor Monitoring*, 60 ALA. L. REV. 41 (2008) (proposing an alternative compensation structure based on approaches common in private equity investments). Investor short-termism may reduce incentives for firms to focus on stakeholders by, for example, reducing environmental degradation or funding worker health and safety programs, since the costs of such measures are incurred in the short term while the benefits (or the risks of failing to do so) are often material, if at all, only in the long term.

135. See, e.g., Choi & Fisch, *supra* note 17, at 317–20; Hess, *supra* note 12, at 240–44. See also Bainbridge, *Limited Shareholder Voting Rights*, *supra* note 35, at 628–35 (questioning the ability and will of institutional investors to engage in activism).

136. See, e.g., Conley & Williams, *supra* note 114, at 36–38. But see Lisa M. Fairfax, *Easier Said Than Done? A Corporate Law Theory for Actualizing Social Responsibility Rhetoric*, 59 FLA. L. REV. 771 (2007) (emphasizing the force of rhetoric in shaping corporate behavior).

137. See Yermack, *supra* note 23, at 15; Buchanan et al., *supra* note 25, at 31.

mainstream financial institutions, many of whom have a history of active engagement with the firms they invest in.¹³⁸

a. Institutional Investors & Enlightened Shareholder Value

At an initial level, investor adoption of an enlightened shareholder value approach can be seen from the UN PRI itself. As of the time of this writing, over 800 institutional investors, asset managers, and industry service providers representing \$20 trillion in assets under management have signed onto the PRI.¹³⁹ U.S. signatories now account for 15% of all PRI signatories and include 20 public, private, and union pension funds, including CalPERS, CalSTRS, AFL–CIO funds, and Connecticut, Illinois, and New York state pension funds, as well as nearly 70 prominent asset managers, such as JP Morgan Asset Management and TIAA–CREF.¹⁴⁰

PRI signatories and other investors are also beginning to implement ESG principles in their investment practices.¹⁴¹ For example, CalPERS and other major public pension plans’ investment guidelines already mandate consideration of certain ESG factors in addition to standard financial analysis.¹⁴² While ESG practices have made slower headway among mainstream mutual funds, Vanguard, a leader in passively managed investments, recently adopted investment policies on the human rights practices of portfolio firms that may pave the way for other passively managed funds to incorporate ESG measures into standard investment analysis.¹⁴³

138. Notwithstanding the public claims of ESV adopters to the contrary, the fact that many of the early ESV proponents are public and union pension funds may itself raise red flags for those concerned that activist investor “enlightenment” simply reflects political pressure, conflicts of interest, and other value-reducing motivations. For a response to this important challenge, see *infra* Part V.

139. PRINCIPLES FOR RESPONSIBLE INVEST. INITIATIVE, ANNUAL REPORT OF THE PRI INITIATIVE 2009, 6 (2009) [hereinafter PRI, ANNUAL REPORT], <http://www.unpri.org/files/PRI%20Annual%20Report%2009.pdf>; *Signatories to the Principle for Responsible Investment*, PRINCIPLES FOR RESPONSIBLE INVEST., <http://www.unpri.org/signatories/> (last visited Oct. 1, 2010). Email from Natalie Beinisch, PRI Academic Network Manager, to author (July 26, 2010, 08:20 CST) (on file with author) (providing updated figures for assets under management).

140. *Id.*

141. See generally PRI, ANNUAL REPORT, *supra* note 139; *Report on Progress 2009*, PRINCIPLES FOR RESPONSIBLE INVEST., 3 (2009), [hereinafter PRI, *Report on Progress*] <http://www.unpri.org/files/PRI%20Report%20on%20Progress%2009.pdf>; Ivo Knoepfel & Gordon Hagart, *Future Proof? Embedding Environmental, Social, and Governance Issues in Investment Markets: Outcomes of the Who Cares Wins Initiative* 16, UN GLOBAL COMPACT (Jan. 2009), http://www.unglobalcompact.org/docs/news_events/8.1/who_cares_wins_29Jan09webversion.pdf (stating that the level of consciousness of ESG issues has improved but progress is uneven).

142. See, e.g., PRINCIPLES FOR RESPONSIBLE INVEST. INITIATIVE, Responses to the 2009 PRI Reporting and Assessment Survey, <http://www.unpri.org/report09> (providing feedback from numerous institutional investors, including CalPERS, Connecticut Retirement Plans and Trust Funds (CRPTF), and the Illinois State Board of Investments, specifically questions 5 through 26); See also Robert G. Eccles and Aldo Sesia, *CalPERS’ Emerging Equity in the Markets Principle* (Harvard Business School Organizational Behavior Unit, HBS Case No. 409–054), available at <http://ssrn.com/abstract=1408570> (reporting on CalPERS’ new investment policy, introduced in 2007, which “allow[ed] CalPERS money managers to invest in companies that were financially attractive and competitively positioned provided their business practices were sound from an environmental, social, and governance (ESG) perspective regardless of where they were located”).

143. Alan Petrillo, *A Win for Investors Against Genocide*, RISKMETRICS GRP. (Mar. 19, 2009), <http://blog.riskmetrics.com/esg/2009/03/a-win-for-investors-against-genocide-vanguard-commits-to-human->

Support for emerging conceptions of enlightened shareholder value is further amplified by its natural overlap with much of the SRI movement, which now accounts for more than 12% of all professionally managed investments in the United States, or \$3.07 trillion assets under management.¹⁴⁴ Although SRI and ESV-oriented investment strategies differ, social investors share enlightened shareholder value's emphasis on non-financial risks and long-term returns.¹⁴⁵ The list of PRI investment advisor signatories is indicative of this, as it includes both "responsible investment" leaders like Domini Social Investments and mainstays of the financial services industry such as Bloomberg LP and Risk Metrics Group/ISS.¹⁴⁶

Financial intermediaries are also beginning to focus on ESG risk measures in making investment allocations. These changes are particularly important because the vast majority of institutional investors rely on external fund managers to make investment decisions and many also delegate proxy voting authority to fund managers.¹⁴⁷ As of 2008, public pension funds in New York, Connecticut, Maryland, and California already required managers to provide ESG disclosure and were including ESG matters in standards for fund manager evaluations.¹⁴⁸ Recent analyst reports of the mutual fund industry also point to a growing recognition of ESG indicators as integral to identifying strong performers. One recent survey of 319 fund managers, only 23% of whom self-identified as "socially responsible investors," found that 99% include ESG factors in their investment analysis and over 70% view ESG as a tool to identify investment opportunities as well as to manage risk.¹⁴⁹ Mainstream financial institutions, such as Citigroup, HSBC, Goldman Sachs, and State Street Global Advisers are also contributing

rights-disclosure.html.

144. As of the start of 2010, 12.2% of all professionally managed assets in the U.S., then valued at \$3.07 trillion, were engaged in some form of SRI or ESG-oriented investing, according to the Social Investment Forum, the U.S. trade association for SRI investment and research. SOCIAL INVESTMENT FORUM FOUNDATION, 2010 REPORT ON SOCIALLY RESPONSIBLE INVESTING TRENDS IN THE UNITED STATES, available at <http://www.socialinvest.org/resources/pubs/>. These figures include over 490 mutual fund products in the United States—with assets totaling \$569 billion. *Id.* See also RISK METRICS GRP., 2008 ESG BACKGROUND REPORT: SUSTAINABILITY REPORTING, 13–14 (May 2008), available at http://www.riskmetrics.com/system/files/private/2008_ESG_Sustainability_Report.pdf [hereinafter 2008 ESG BACKGROUND REPORT] (reporting that this represents a growth in SRI assets of over 18%, compared to 3% for non-SRI managed assets).

145. Although most enlightened-shareholder-value investors do not rely on screening strategies, screening-based SRI is compatible with enlightened shareholder value insofar as its ultimate objective is generating long-term shareholder wealth. See Kurtz, *supra* note 110, at 249, 251–53 (noting that SRI is no longer solely the domain of religious orders and other altruistic or "values-based" investors, but now includes "value-seeking" investors as well). The primary difference is that ESV-oriented investors would not generally share some social investors' tolerance for investments that generate below-benchmark returns but are stronger on ethical measures.

146. See Signatories to the Principles for Responsible Investment, PRINCIPLES FOR RESPONSIBLE INVEST. INITIATIVE, <http://www.unpri.org/signatories/> (last visited Oct. 15, 2010).

147. See Choi & Fisch, *supra* note 17, at 324 (reporting that over 84% of assets of the pension funds surveyed were externally managed).

148. Hugh Wheelan, *Investors Increase Demands for ESG on All Manager Hires*, RESPONSIBLE INVESTOR (Feb. 26, 2008), <http://www.responsible-investor.com/home/article/esg>.

149. Danyelle Guyett, *ESG Ratings of Fund Managers—a Step Closer Towards the Mainstreaming of ESG Integration*, MERCER (July 4, 2008), <http://www.mercer.com/referencecontent.htm?idContent=1311535>; Andrew Coen, *New Approach to Social Investing Finds Favor*, INVEST. NEWS (Feb. 1, 2009), <http://www.investmentnews.com/article/20090201/REG/302019971>.

to or endorsing research on ESG implementation and integration.¹⁵⁰

New analytical tools and investor advisory services, while in their early stages, are being developed to help investors and financial intermediaries overcome the practical obstacles to defining, quantifying, and tracking extra-financial factors, such as "sustainability," a commitment to labor standards, or a positive human rights record, in a comparable and consistent manner.¹⁵¹ In the past two years, Fidelity Investments, Merrill Lynch, Goldman Sachs, and Bloomberg have begun to make ESG performance indicators and ratings available to clients as part of their research tools for listed companies.¹⁵² What is most interesting about these tools is that they are being developed to reach mainstream investors, not simply those adopting screening or other traditional SRI strategies.

The global economic crisis has also moved public opinion and public policy further in the direction of enlightened shareholder value by calling attention to the dangers of short-term investment strategies and encouraging a reassessment of the balance between risk taking and risk management.¹⁵³ As a result, a number of public pension funds and other asset owners are beginning to review their compensation practices in order to better focus fund managers on long-term performance.¹⁵⁴ Recently adopted SEC disclosure rules now encourage tighter board (and investor) monitoring of corporate risk

150. In addition to those named above, studies by the UNEP Finance Initiative have been endorsed or supported by ABN Amro, the Conference Board, Credit Suisse Group, the IFC, Innovest (now a part of RiskMetrics), UBS, and the World Bank Group, among others. UNEP FINANCE INITIATIVE, *supra* note 119.

151. On efforts to standardize ESG metrics, see generally Steve Lydenberg et al., *From Transparency to Performance: Industry-Based Sustainability Reporting on Key Issues* (June 2010), available at http://hausercenter.org/iri/wp-content/uploads/2010/05/IRI_Transparency-to-Performance.pdf; Alexander Bassen & Ana Maria Masha Kovacs, *Environmental, Social and Governance Key Performance Indicators from a Capital Market Perspective*, 9 ZEITSCHRIFT FÜR WIRTSCHAFTS- UND UNTERNEHMENSETHIK [J. FOR BUS., ECON. & ETHICS], 182 (2008), available at <http://ssrn.com/abstract=1307091>. Standards for verifying and reporting greenhouse gas emissions data have also emerged in connection with the Climate Registry and the Carbon Disclosure Project. See Commission Guidance Regarding Disclosure Related to Climate Change, Securities Act Release No. 33-9106, 75 Fed. Reg. 6292 (Feb. 2, 2010) (to be codified at 17 C.F.R. pts. 211, 231, 241) [hereinafter Commission Guidance].

152. See *Research Firm Details: RiskMetrics Group*, FIDELITY.COM, <http://research2.fidelity.com/fidelity/research/reports/release2/ResearchFirmDetails.asp?page=KLDResearch.asp> (last visited Sept. 13, 2010) (describing ESG Composite Ratings available through RiskMetrics/Innovest's "Intangible Value Assessment," which offers investors quantitative ESG data based on measures developed by GRI and KLD); *RiskMetrics' Intangible Value Assessment*, RISKMETRICS, <http://www.riskmetrics.com/iva> (last visited Sept. 13, 2010); Innovest Strategic Value Advisors, Innovest Strategic Value Advisors & the United Nations Principles for Responsible Investment, PRINCIPLES FOR RESPONSIBLE INVEST. INITIATIVE (Jan. 2007), available at http://www.unpri.org/files/Innovest_PRI_Services.pdf. See also Mindy S. Lubber, *Companies Come Clean on Climate Change*, BLOOMBERG BUS. WK. June 3, 2009 available at http://www.businessweek.com/technology/content/jun2009/tc2009063_019035.htm; *Customers*, ASSET4 (Oct. 11, 2010), available at <http://www.asset4.com/page456.html> (detailing a customer list and testimonials for ASSET4, a leading ESG analytical provider).

153. See, e.g., Amendments to Regulation SHO of the Exchange Act, 75 Fed. Reg. 11,232 (Mar. 10, 2010) (to be codified at 17 C.F.R. pt. 242) (placing limits on short selling). See also King & Spalding, *Lead Director Network*, VIEWPOINTS (July 24, 2009), available at http://www.kslaw.com/library/publication/LDN_ViewPoints_4.pdf (presenting views of leading directors of Fortune 500 companies on board oversight of risk management and the need to consider broader measures of risk).

154. See 2008 ESG BACKGROUND REPORT, *supra* note 144, at 14. On the problem of short-term-oriented fee structures, see ASPEN INST., *supra* note 134.

management functions at a time when many investors recognize the importance of broader measures of risk, including ESG risks, in evaluating long-term firm performance and in portfolio risk analysis.¹⁵⁵ These developments suggest that the emergence of enlightened shareholder value and broader economic trends may be mutually reinforcing and may together contribute to a fundamental reassessment of what corporate accountability to shareholders requires.

b. Translating Enlightened Shareholder Value to Firms

For investor-driven enlightened shareholder value to impact corporate decision-making, a broader vision of corporate accountability must ultimately be transmitted to corporate boards and managers. But what precisely is the mechanism by which this occurs? And if enlightened shareholder value is advanced through market forces rather than through regulatory mandate, to what extent, if at all, does it “have teeth?”

At base, ESG-oriented investors influence firms by communicating that recognizing, reporting, and responding to ESG risks matters. This occurs as institutional investors use the tools of shareholder activism—primarily voting, utilizing shareholder proposals, and engaging directly with firms—to seek more comprehensive disclosure from portfolio firms on stakeholder impacts. Investors can also urge investment intermediaries to take this information into account when allocating investments and direct them to communicate to firms that investors are basing investment decisions in part on ESG measures.

Disclosure requirements under U.S. federal securities regulations, including those under Regulation S-K¹⁵⁶ and Regulation S-X,¹⁵⁷ already mandate that firms disclose ESG risks or other information if there is a substantial likelihood that a reasonable investor would consider it important in deciding how to vote or make an investment decision, or if it would alter the total mix of available information.¹⁵⁸ For example, as the SEC reaffirmed in January 2010, the legislative, regulatory, business, market, and physical impacts of climate change are increasingly material to public companies and investors and must therefore be addressed in regular public filings.¹⁵⁹ Strong mandatory sustainability reporting obligations strengthen the requirements that apply to foreign

155. See, e.g., Proxy Disclosure Enhancements, Release Nos. 33-9089; 34-61175, 74 Fed. Reg. 68,334, (Feb. 28, 2010) (to be codified at 17 C.F.R. pts. 229, 239, 240, 244, 274) (discussing proxy disclosure requirements regarding board oversight of risk management). The Dodd–Frank Reform Act also requires risk committees to be established by publicly traded bank holding companies with more than \$10 billion in assets and certain non-bank financial companies supervised by the Board of Governors of the Federal Reserve. Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 165(h), 124 Stat. 1376, 1429–30 (2010).

156. 17 C.F.R. § 229.304–305 (1982).

157. 17 C.F.R. § 210 (1985).

158. *TSC Indus. v. Northway, Inc.*, 426 U.S. 438, 449 (1976); *Basic Inc. v. Levinson*, 485 U.S. 224, 231–32 (1988) (extending the *TSC Industries* standard to all actions under the antifraud provisions of Section 10(b) of the Securities Exchange Act of 1934). Uncertainty as to materiality should be “resolved in favor of those the statute is designed to protect,” that is, investors. *TSC Indus.*, 426 U.S. at 448.

159. See Commission Guidance, *supra* note 151, at 6290–97 (identifying relevant regulations that should incorporate climate change disclosures, including in particular, Management’s Discussion and Analysis (MD&A)).

investors with interests in U.S. firms¹⁶⁰ and to some U.S. firms listed in the United Kingdom and Europe.¹⁶¹

Investor advocacy of stakeholders also comes in the context of a resurgent corporate social responsibility movement that in both the United Kingdom and the United States has proven to be a powerful driver toward broader measures of accountability.¹⁶² Many corporations face market pressure from consumers, employees, and civil society to consider their impact on stakeholders.¹⁶³ As a result, the vast majority of U.S. public corporations already voluntarily issue "sustainability," "triple-bottom-line" (financial, social, and environmental), ESG, or annual reports describing their commitment to stakeholders,¹⁶⁴ generally based on indicators developed by the Global Reporting Initiative (GRI).¹⁶⁵ Many investment analysts see sustainability reporting in any of these forms as an important risk assessment tool.¹⁶⁶

However, investor demand is still critical to driving improved ESG reporting and performance.¹⁶⁷ ESG disclosures under the securities laws have on the whole been limited in quantity and scope, whether because these risks have not been identified by firms, because they have not previously been viewed to be material, or because firms generally adopt a conservative approach toward qualitative and forward-looking disclosures.¹⁶⁸ Voluntary disclosures, while more widespread, are inherently selective and for many institutional investors are inadequate to ensure transparency, accountability,

160. For example, in 1999 the United Kingdom amended its pension regulations to require trustees of local public pension funds to disclose the extent to which "social, environmental or ethical considerations are taken into account in the selection, retention, and realization of investments" as well as any policies concerning the exercise of voting rights associated with their investments. See Williams & Conley, *supra* note 7, at 504 (referencing the 1999 amendments to the U.K. Pensions Act of 1995). *But see* Clark & Knight, *supra* note 89, 270–71 (2009) (finding that the 1999 regulations had little impact because the primary obligations fell on fund managers rather than on institutional investors themselves).

161. See *supra* note 89 (explaining U.K. requirements). See also Williams & Conley, *supra* note 7, at 502–10 (describing requirements in continental Europe).

162. See generally THE ECONOMIST, Jan. 19, 2008 (special issue on corporate social responsibility).

163. See generally Lisa M. Fairfax, *The Rhetoric of Corporate Law: The Impact of Stakeholder Rhetoric on Corporate Norms*, 31 J. CORP. L. 675 (2006); Larry E. Ribstein, *Accountability and Responsibility in Corporate Governance*, 81 NOTRE DAME L. REV. 1431, 1442–59 (2006) (describing these trends). See also GOLDMAN SACHS GLOBAL INVESTMENT RESEARCH, INTRODUCING GS SUSTAIN 22 (June 22, 2007), available at www.unglobalcompact.org/docs/summit2007/S1_GOLDMAN_Ling.pdf (reporting studies showing that 53% of U.S. consumers actively seek information on corporate social performance).

164. See generally Fairfax, *supra* note 163, at 691–94 (finding that over 50% of Fortune 500 companies produce sustainability reports and that nearly 90% of Fortune 500 companies' annual reports address stakeholder issues). See also Williams & Conley, *supra* note 7, at 496 (observing that the "identification and disclosure of corporate information concerning social and environmental risks" is itself a prime indicator of pro-stakeholder convergence).

165. See generally GLOBAL REPORTING INITIATIVE, www.globalreporting.org (last visited Sept. 19, 2010). For comparisons of widely used indicators and standards, see generally COOPER, *supra* note 3, at 32–42.

166. See *supra* note 163 and accompanying text. See also 2008 ESG BACKGROUND REPORT, *supra* note 144, at 21.

167. The PRI itself is intended to improve the level and quality of non-financial reporting, particularly under the UN Global Compact. PRINCIPLES FOR RESPONSIBLE INVESTMENT, www.unpri.org (last visited Sept. 13, 2010); UNITED NATIONS GLOBAL COMPACT, www.unglobalcompact.org (last visited Sept. 13, 2010).

168. See, e.g., B.C. Inv. Mgmt. Corp. (Can.) et al. as Petitioners, Supplemental Petition for Interpretative Guidance on Climate Risk Disclosure, at 21–31, No. 4-547 (Nov. 23, 2009), available at www.sec.gov/rules/petitions/2009/petn4-547-supp.pdf (citing studies evidencing this point).

and comparability with respect to ESG issues.¹⁶⁹ In the absence of legally mandated ESG disclosures investors are therefore increasingly engaging with companies to advance corporate governance reform that includes closer attention to ESG issues and increasingly vocal about the types of information they regard as material to their investment decisions.

i. Litigation

In the United Kingdom, Section 172 of the Companies Act is enforceable through shareholder litigation.¹⁷⁰ However, early implementation experience there suggests that the anticipated flood of shareholder suits has not materialized. Rather, the primary effect of the law has been to urge companies to more carefully document their consideration of the impact of corporate decisions on stakeholders.¹⁷¹

In the United States, litigation is not likely to be a significant means of promoting an enlightened shareholder value decision rule, with the possible exception of claims challenging inadequate or misleading disclosures under the securities laws. As in the United Kingdom, stakeholders that are not also shareholders would not have standing to initiate a lawsuit against a company for management failure to respond to ESG risks, and such a case would only be brought where significant financial losses resulted.¹⁷² However, the Delaware Court of Chancery's decision in *In re Citigroup* has reaffirmed the strength of the business judgment rule with respect to risk management, making clear that shareholder litigation alleging director failure to adequately oversee risk management

169. A potential critique of the claim that investment strategies incorporating ESG measures may benefit market efficiency and "first mover" investors is that such information is in fact already publicly available, either through existing mandatory disclosures or through voluntary corporate disclosures. However, the success of an investor-driven enlightened shareholder value paradigm depends on quantifiable, verifiable, standardized, and comparable ESG metrics being incorporated into analytical models used by mainstream investors, analysts, and investment intermediaries, all efforts that are presently in their early stages. *See supra* note 151 (citing studies identifying and developing such metrics). Observers also note the limitations of existing disclosure regimes and have described the types of information that would facilitate expanded integration of ESG factors into investment analytics but are *not* uniformly available to the markets. *See id.* (describing limitations to said metrics). *See also* Commission Guidance, *supra* note 151, at 7–10 (describing level of current disclosures related to climate change); Michael R. Siebecker, *Trust & Transparency: Promoting Efficient Corporate Disclosure Through Fiduciary-Based Discourse*, 87 WASH. L. REV. 115, 127–36 (2009) (arguing for an interactive, process- and discourse-based approach to corporate disclosure); Aaron Bernstein, *Incorporating Labor and Human Rights Risk Into Investment Decisions* (Harvard Law School Pensions and Capital Stewardship Project Occasional paper No. 2, Sept. 2008), available at http://www.law.harvard.edu/programs/lwp/pensions/publications/occpapers/occasional_paper2.pdf (describing challenges to the integration of labor and human rights factors into ESG-based investment criteria and proposing solutions); Cynthia A. Williams, *The Securities and Exchange Commission and Corporate Social Transparency*, 112 HARV. L. REV. 1197, 1289–93, 1299–1311 (1999) (describing the limits of corporate social disclosures under the securities laws, including the problems of differential access and incomplete or noncomparable information). On the failure of markets to account for certain nonfinancial measures of corporate performance, see also *supra* note 131.

170. Companies Act, 2006, c. 46, §§ 260–69 (U.K.) (introducing a new derivative action exercisable by members (i.e. shareholders)).

171. *See* Loughrey et al., *supra* note 7, at 96–101, 110–11.

172. *See* Keay, *supra* note 91, at 29–32 (suggesting how claims might arise under § 172). The claims arising from the Gulf of Mexico oil disaster against British Petroleum PLC offer an example of one type of context in which shareholder litigation precipitated by a failure to attend to such risks might arise.

or mitigate potentially high-impact risks will be unlikely to prevail there.¹⁷³ The court held that Citigroup’s directors and officers were not liable for a breach of the duty of oversight articulated in *In re Caremark* for allegedly failing to mitigate “excessive” business risk that resulted in catastrophic losses to shareholders during the subprime mortgage crisis.¹⁷⁴

ii. Voting & Engagement

Another option is for investors to simply divest from firms with poor ESG performance (i.e., the “Wall Street Walk”). However, exit will in most cases be “invisible” to the firm absent any other communications from the investor and may not be a viable option for many investors with large holdings. In contrast, the exercise of voting power and direct negotiation with management are increasingly powerful tools for investors to influence corporate practice.

Investors have the power to vote for the election of directors (or withhold votes from candidates they disapprove of), initiate or support shareholder proposals, and—under “say on pay” voting measures now mandated by the Dodd–Frank Act—“comment” on executive compensation. Empirical studies indicate that even when unsuccessful, a strong vote for a shareholder proposal, or weak support for a management proposal or director nominee, often sparks changes in the board, management, or corporate practices in the aftermath of the vote.¹⁷⁵ ESV-oriented investors can therefore leverage their support for director candidates, executive compensation, or governance measures in a way that rewards directors who are well-aligned with an enlightened shareholder value approach.

Shareholders can also directly advocate for stakeholder interests through “social activism,” that is, shareholder activism around labor, environmental, or human rights issues. To date, shareholder social proposals and related shareholder campaigns have tended to be ad hoc, issue-specific, and driven by ethically-motivated and interest group investors rather than by mainstream institutional investors.¹⁷⁶ Few have actually passed.¹⁷⁷

However, recent years have witnessed a growing level of shareholder (and proxy advisor) support for social or environmental proposals, approaching levels more typical of governance-related initiatives.¹⁷⁸ Even some mutual funds, including those managed

173. *In re Citigroup Inc. S’holder Deriv. Litig.*, 964 A.2d 106 (Del. Ch. 2009).

174. *Id.* at 121–31 (interpreting and applying the standard for oversight liability set forth in *In re Caremark Int’l Inc. Deriv. Litig.*, 698 A.2d 959 (Del. Ch. 1996)). *Cf.* *Am. Int’l Grp. Inc., Consol. Deriv. Litig.*, 965 A.2d 763, 796–99 (Del. Ch. 2009) (finding claim for *Caremark* failure of oversight supported at the pleadings stage).

175. *See* Yermack, *supra* note 23, at 6–8 (examining the impact of shareholder voting on boards and corporate strategy).

176. A prime example is the anti-apartheid divestment campaign surrounding the Sullivan Principles, which was the first major “responsible investment” shareholder-driven movement. It lost momentum and dissolved once apartheid ended. *See generally* S. PRAKASH SETHI & OLIVER F. WILLIAMS, *ECONOMIC IMPERATIVES AND ETHICAL VALUES IN GLOBAL BUSINESS: THE SOUTH AFRICAN EXPERIENCE AND INTERNATIONAL CODES TODAY* 127–246 (2000) (comparing anti-apartheid divestment campaigns to modern shareholder campaigns). More recent campaigns targeting investment in Burma and Sudan appear to have followed the same issue-centric approach.

177. *See* 2008 ESG BACKGROUND REPORT, *supra* note 144 (reviewing empirical studies). For example, resolutions on human rights typically gain less than five percent support from shareholders. *Id.*

178. For example, investor support for proposals calling for companies to produce emissions reports or set

by TIAA–CREF, Charles Schwab, and Credit Suisse, are increasing their support for shareholder proposals on climate change.¹⁷⁹ In addition, a large number of the social and environmental proposals submitted annually are withdrawn, which often indicates that management has been willing to adopt some portion of the action requested by shareholders.¹⁸⁰ For example, the withdrawal of over two-thirds of shareholder proposals requesting corporate sustainability reporting seems to confirm that sustainability reporting is gaining acceptance among mainstream investors, advisors, financial analysts, and managers.¹⁸¹

In October 2009, the SEC opened the door further to shareholder engagement around ESG issues by adopting a new policy that will allow more shareholder proposals pertaining directly to risk management or requiring a risk analysis to go forward.¹⁸² This policy allows investors to urge firms to focus on risks (both governance (G) and environmental/social (E/S)-related) previously disregarded by the firm but which investors consider material. In addition, the increasing convergence between the identity, goals, and strategies of corporate governance and social activism may give stakeholder issues increased prominence as a focus of mainstream investor engagement.¹⁸³

A final development that is contributing to the emergence of enlightened shareholder value are networks for coordinated investor (and NGO) engagement, often around an ESG or social responsibility mission. Coordination amplifies investor voice by facilitating direct information exchange, collaboration, and goal identification, much of which can now be done without falling afoul of the SEC rules for proxy solicitations.¹⁸⁴

emissions reduction targets averaged 32% investor support in 2008, with one receiving majority support for the first time in 2009. Social and environmental proposals received, on average, 14% of the shareholder vote, up from an average 10% support at 360 companies in 2005. RISKMETRICS GROUP, POSTSEASON REVIEW: SOCIAL PROPOSALS (2008), *available at* www.riskmetrics.com/governance_weekly/2008/154.html; RISKMETRICS GROUP, POSTSEASON REPORT (Oct. 2009), *available at* <http://www.riskmetrics.com/docs/2009-postseason-report>. ISS, a leading proxy advisor, generally recommends support of social proposals; RISKMETRICS GROUP, 2010 SRI PROXY VOTING GUIDELINES EXECUTIVE SUMMARY 5 (Jan. 2010) *available at* www.riskmetrics.com/sites/default/files/RMG_2010_SRI_Summary.pdf.

179. One recent study reviewing the proxy votes of 74 mutual fund families, together representing \$3.8 trillion in assets under management, on shareholder-sponsored climate change resolutions from the 2004 to the 2008 proxy season found that these and other major mutual funds are increasing their support for shareholder proposals on climate change. ROB BERRIDGE & JACKIE COOK, MUTUAL FUNDS AND CLIMATE CHANGE: GROWING SUPPORT FOR SHAREHOLDER RESOLUTIONS 2–3 (May 2009) *available at* www.ceres.org/mutualfunds09.

180. 2008 ESG BACKGROUND REPORT, *supra* note 144. The number of shareholder proposals urging boards to adopt voluntary corporate sustainability reporting has also risen in recent years. *Id.* at 3–4 (reporting such proposals have generally attracted over 25% shareholder support in recent years).

181. *Id.* (reporting that over two-thirds of such proposals were withdrawn without a vote in during the 2007 and 2008 proxy season); RISKMETRICS GROUP, POSTSEASON REPORT (Oct. 2009), *supra* note 178, at 15–16 (reporting similar results for environmental proposals during the 2009 proxy season).

182. SEC STAFF LEGAL BULLETIN 14E (Oct. 27, 2009), *available at* <http://sec.gov/interp/legal/chslb14e.htm>.

183. *See generally* Amiram Gill, *Corporate Governance as Social Responsibility: A Research Agenda*, 26 BERKELEY J. INT'L L. 452 (2008) (describing the intersections between corporate governance and corporate social responsibility); Ann K. Buchholtz et al., *Corporate Governance and Corporate Social Responsibility*, in THE OXFORD HANDBOOK OF CORPORATE SOCIAL RESPONSIBILITY, *supra* note 110, at 327 (surveying the literature).

184. The rules do not cover communications by investors that do not seek voting authority, and exclude announcements of how an investor intends to vote. *See* BAUMAN ET AL., *supra* note 18, at 528–29 (explaining

This reduces the collective action barriers and free rider problems of shareholder activism.

The PRI itself is a prime example. Coordinated engagement under the PRI extends beyond traditional core corporate governance concerns to direct advocacy of stakeholder interests, including some beyond a strict environmental or social/labor focus.¹⁸⁵ Other institutional investor collaborations include the Carbon Disclosure Project, an international coalition of institutional investors that pushes the largest global corporations to disclose their level of greenhouse gas emissions.¹⁸⁶ Yet another, the Coalition for Environmentally Responsible Economics (CERES), has initiated the global Investor Network on Climate Risk (INCR), bringing together leading institutional investors, investment funds, and environmental public interest organizations.¹⁸⁷ The SEC’s recent guidance on climate change reporting is one example of the potential impact of such coalitions, as it was issued in response to requests from CERES and a number of public pension funds, among others.¹⁸⁸ These global coordination mechanisms can be viewed as a type of “meta-regulation,” leveraging participants’ reputational interests to give “teeth” to otherwise voluntary commitments and translate them down the investment chain to financial intermediaries and corporations.¹⁸⁹

V. SHAREHOLDER ENLIGHTENMENT AND THE CORPORATE OBJECTIVE FUNCTION

This Article has thus far presented a basic descriptive claim: that an “enlightened shareholder value” (ESV) perspective is emerging as an increasingly relevant paradigm for mainstream institutional investors and many U.S. public corporations. It has also examined the basic rationales advanced in support of enlightened shareholder value from the standpoint of institutional investors.

These developments raise a number of fundamental questions that previous studies have not addressed. For example, what precisely does enlightened shareholder value mean in the U.S. context, and what might enlightened shareholder value offer as an

the 1992 reforms to the SEC proxy solicitation rules).

185. For example, in 2008, a group of 52 PRI signatories, including several from the U.S., conducted a joint initiative to urge 9000 listed companies to commit to sustainable business practices and the principles of major international conventions under the United Nations Global Compact. *Collective Engagements by PRI Signatories*, PRINCIPLES FOR RESPONSIBLE INVEST., <http://www.unpri.org/collaborations/#3> (last visited Sept. 19, 2010). See also Press Release, PRINCIPLES FOR RESPONSIBLE INVESTMENT, Global Investors Issue US \$4 trillion Incentive for Sustainability, 1–2 (October 27, 2008), <http://www.unpri.org/files/prfinalef2610.pdf> (stating that U.S. signatories included CalPERS, the Calvert Group, NYCERS, and several private pension funds and foundations).

186. CARBON DISCLOSURE PROJECT, <https://www.cdproject.net/> (last visited Sept. 19, 2010).

187. COALITION FOR ENVIRONMENTALLY RESPONSIBLE ECONOMICS, <http://www.ceres.org/> (last visited Sept. 19, 2010).

188. See Commission Guidance, *supra* note 151, at n.20 (acknowledging CERES’ submission of study results regarding climate risk disclosure). For petition signatories, see, e.g., Supplemental Petition, *supra* note 168, at 31–32.

189. See CHRISTINE PARKER, *THE OPEN CORPORATION: EFFECTIVE SELF-REGULATION AND DEMOCRACY* 245–91 (2002) (defining “meta-regulation” as “the regulation of self-regulation”). It should be noted that while some of the signatory engagements coordinated under the auspices of the PRI, including those identified at *supra* note 185, serve a “meta-regulatory” role, not all can be so classified. Thanks to Natalie Beinisch, Academic Network Manager of the UNPRI, for her comments on this point.

alternative to shareholder wealth maximization? Or is enlightened shareholder value no more than shareholder wealth maximization in a new “responsible” guise? If enlightened shareholder value in fact suggests an alternative vision of the corporate purpose, what does it mean as a standard for managerial decision-making, and how well does it fit within existing corporate governance rules?

This Part offers an initial response to these questions by clarifying the contours of an investor-driven enlightened shareholder value paradigm. It then presents normative arguments in favor of an ESV model and considers how ESV addresses some of the questions surrounding shareholder empowerment and potential shareholder advocacy of stakeholders.

A. Enlightened Shareholder Value: Revising the Corporate Objective Function

As described in Part II, the standard shareholder primacy paradigm incorporates: (i) the view that the purpose of the corporation is to maximize shareholder wealth; (ii) the principle that ultimate control of the corporation rests with shareholders; and (iii) the identification of shareholders as the corporate constituency that may exercise monitoring and oversight rights over corporate boards. As we have seen, investor-driven enlightened shareholder value has, as in the United Kingdom, not been directed toward transforming current corporate governance structures to make corporate boards *directly* accountable to nonshareholders. I will also show below that ESV does not mandate any shift in current corporate governance rules. Instead, ESV is at base a revision of the first element—the corporate objective function—that is, the standard against which “success” of the corporate enterprise is measured.

In altering only this first dimension, ESV is only a moderate step from the “standard” shareholder primacy paradigm. For reasons discussed below, it fits, perhaps paradoxically, even more comfortably within current corporate law, which is fundamentally director-centric and gives directors and officers broad discretion to take stakeholder interests into account. In addition, enlightened shareholder value suggests managerial decision rules that could reduce negative externalities as well as motivate innovation in directions that generate positive outcomes for shareholders and other corporate constituencies.

1. The Enlightened Shareholder Value Alternative: Distilling Decision Rules

From Part IV, we can readily identify a number of the defining elements of investor-driven enlightened shareholder value. First and foremost, the expressions of investor-driven ESV explored here are motivated by the view that stakeholder issues have an economic impact on firms’ long-term profitability and risk profile and, therefore, on the long-term value of investor portfolios. Second, while ESV investors are only in some cases *directly* advancing the interests of stakeholders—for example through social activism—they are at least *indirect* advocates of stakeholders by emphasizing the importance of environmental, social, governance, and other extra-financial measures of corporate performance. Finally, this vision of ESV depends on market pressure from investors and affirms the priority of shareholder value in managerial decision-making. In short, investor-driven ESV shares with the U.K. approach a focus on generating long-term shareholder wealth *through* investor and management attention to the firm’s impact

on extended stakeholder constituencies.

a. Enlightened Shareholder Value & Shareholder Wealth Maximization

The conventional understanding of shareholder wealth maximization has always been that corporations should maximize *long-term* returns to shareholders.¹⁹⁰ Since enlightened shareholder value also sets long-term shareholder wealth as the fundamental standard for evaluating corporate success, then perhaps, as some have argued, enlightened shareholder value is no more than “shareholder primacy with an ESG cherry on top.”¹⁹¹ But is this in fact the case?

First consider cases where shareholders’ long-term interests are coextensive with stakeholder interests—for example, a decision to build an alternative energy plant that will generate jobs, clean energy, and profits. Similarly, in some sectors consumer demand for “sustainable” business practices may reward companies who deliver with increased profitability and market share. In these cases, the economic impact on the firm of an ESV approach might well be the same or better than under a shareholder wealth maximization approach and might at the same time generate greater economic and intangible benefits to other firm constituencies. Likewise, if management is considering several courses of action with comparable expected financial benefits, but some options confer a greater net benefit on stakeholders, then an ESV decision rule would preference the latter, essentially encouraging the firm to produce *positive* externalities. In contrast, an analysis based on shareholder wealth maximization would not suggest a basis for selecting between two courses of action expected to be equally profitable.

Under the more common scenario, management must make tradeoffs among competing constituencies. Customer demand for low prices, employee demand for secure employment and competitive compensation, and shareholder demand for market or above-market returns will often be at odds. In a pure profit-maximization approach, the only relatively clear constraints on managerial decision-making are limits explicitly imposed by law. While neither shareholder wealth maximization nor an ESV approach offers a hard and fast rule for quantifying and weighing competing interests and their respective costs and risks,¹⁹² an ESV approach makes ESG and stakeholder-related risks increasingly salient to corporate management as part of the decision calculus.

Under the stakeholder salience model developed by Mitchell, Agle, and Wood, the importance of a stakeholder group to management depends on its relative “salience.” Mitchell et al. define “salience” with reference to the stakeholder’s *power* to produce desired outcomes, the *legitimacy* or appropriateness of their claims, and the *urgency* of the issue to the stakeholder.¹⁹³ For example, if a firm is weighing whether to adopt new technologies to reduce pollutant emissions or to maintain a competitive edge by

190. See, e.g., Hansma & Kraakman, *supra* note 14, at 439 (describing the goal of the corporation, and of corporate law, as “principally striv[ing] to increase *long-term shareholder value*”) (emphasis added).

191. Branson, *supra* note 15.

192. Indeed, we might also question the assumption implicit in the examples here that the financial implications of any decision (i.e., ultimately, shareholder value) can be disaggregated from consideration of stakeholder issues to meaningfully compare the costs and benefits.

193. See Ronald K. Mitchell et al., *Toward a Theory of Stakeholder Identification and Salience: Defining the Principle of Who and What Really Counts*, 22 ACAD. MGMT. REV. 853 (1997) (proposing a theory of stakeholder salience). See also COOPER, *supra* note 3, at 39–41 (describing this work and related literature).

continuing to pollute—and if we assume further that the pollution level is within legal limits and there are no reasons beyond environmental benefits to install the new technologies—then a firm might rationally decide to do nothing. However, if investors are expressing concern about environmental impact or regulatory risks confronting the firm—or are demanding more comprehensive public reporting of such issues—their influence is likely to increase the perceived legitimacy and urgency of environmental and community concerns for the firm. By lending their “power” to stakeholder concerns, investors’ voices also increase the likelihood that the firm will respond.

However, it is in the cases like the one above—where market forces pressure firms away from social responsibility—that the contrast between shareholder wealth maximization and enlightened shareholder value is clearest. These are cases where a course of action that maximizes profits imposes negative externalities on stakeholders—for example, by disregarding human rights or paying minimal heed to environmental impact. If permitted by law, such decisions are fully compatible with a shareholder wealth maximization approach. Under an ESV decision rule, in contrast, the firm must assess the potential impact on stakeholders. If a course of action is optimal only when the costs to stakeholders are ignored, then it should not be taken or the firm must absorb the costs.¹⁹⁴ Of course, in some cases absorbing these costs will likely have an impact on at least short-term profits or may prevent the firm from reaching the level of earnings it might otherwise have achieved. For example, adoption of a greenhouse gas mitigation strategy might require significant expenditures with benefits realized only in the long term, or a firm may elect not to undertake a potentially profitable investment in a country where it is unable to minimize the risk of human rights violations by its subsidiaries in a cost-effective manner.

These examples demonstrate that while enlightened shareholder value is by definition focused on driving long-term corporate profitability, it is not in all cases strictly wealth-maximizing. Part V.A.1.b below articulates a number of justifications in favor of the ESV decision rules presented here, including those that are to some degree profit-sacrificing. Einer Elhauge has also presented strong arguments supporting managerial discretion to sacrifice profits in cases such as these on both efficiency and ethical grounds.¹⁹⁵ Regardless, commentators observe that, as a matter of practice, managers routinely take into account a range of competing interests and priorities in reaching decisions on behalf of the corporation and must do so without the benefit of hindsight and perfect information about the ultimate effect of their decisions on the financial success of the corporation, however defined.¹⁹⁶ Indeed, as Elhauge notes, “pure profit-maximization does not empirically appear to be a prevalent social norm” among investors or corporate managers.¹⁹⁷

194. For a discussion of the primary mechanisms for motivating firms to internalize some of these costs, see *supra* Part IV.B.3. The firm may, of course, be able to avoid doing so in cases where managerial decisions and their impact are not publicly disclosed.

195. See generally Elhauge, *supra* note 72 (discussing the benefits of managerial discretion to sacrifice corporate profits).

196. See, e.g., Jensen, *supra* note 55, at 16; Fisch, *supra* note 68, at 655 (surveying studies of managerial practice).

197. Elhauge, *supra* note 72, at 814.

b. Enlightened Shareholder Value Decision Standards

Under an enlightened shareholder value paradigm then, generating long-term shareholder wealth is the fundamental objective for corporate decision-making, but multiple financial and non-financial stakeholders must be taken into account in the pursuit of financial success. Accordingly, ESV decision rules must look beyond quarterly earnings or other traditional measures of shareholder value. They must also incorporate an assessment of the decision’s cost impact that is not limited to the anticipated direct financial costs incurred by the firm, but instead includes costs borne by other firm constituencies that can be reasonably identified and quantified.

Although enlightened shareholder value has yet to be consistently operationalized as a yardstick for management success, there are a number of possible measures of “successful” decision-making that are consistent with this basic ESV decision rule. I consider two here by way of example. As enlightened shareholder value is investor-driven, these measures are proposed primarily as a standard for *operational* decision-making, not for change of control or game-ending corporate decisions, where there is no long-term investment horizon. In those cases, existing corporate codes and case law governing change of control transactions, which, again, generally permit consideration of stakeholder interests, would of course apply.¹⁹⁸

i. Long-Term Firm Value or “Joint Output”

Although ESV advocates tend to stress its impact in terms of traditional shareholder value measures, broader measures of firm value are in fact a better fit with an ESV approach. Measures of firm value reflect the joint output of shareholders, employees, lenders, communities, and all other contributors to the corporate enterprise. In this regard, enlightened shareholder value is largely consistent with Blair and Stout’s team production model of the firm,¹⁹⁹ the enlightened *stakeholder* value model proposed by economist Michael Jensen,²⁰⁰ and other approaches that also specify long-term *firm* value maximization as the firm’s objective rather than shareholder value.²⁰¹

However, an ESV-oriented measure of firm value would potentially incorporate a broader range of stakeholders than financial claimants of the firm, as Jensen and Thomas Smith have proposed, or those with firm-specific investments, as in the Blair and Stout model. Instead, the limiting factor in investor-driven enlightened shareholder value is simply what *investors* identify as having a potentially material effect on firm performance, which may include measures of costs borne by the environment, local communities, and other non-financial claimants as well.²⁰² Economists and corporate

198. *Supra* Part III(A) (surveying these authorities).

199. *See generally* Blair & Stout, *supra* note 29.

200. *See* Jensen, *supra* note 55, at 8, 12–13 (arguing that joint output can only be measured by a comprehensive assessment of firm value that internalizes the costs and returns to all residual financial claimants). Jensen excludes non-financial claimants from the definition of “stakeholders” because, in his view, the interests of these claimants fall within the scope of externalities properly dealt with through regulation. *Id.* at 12 (“[r]esolving externality and monopoly problems is the legitimate domain of the government”).

201. *See, e.g.*, Thomas A. Smith, *The Efficient Norm for Corporate Law: A Neotraditional Interpretation of Fiduciary Duty*, 98 MICH. L. REV. 214, 217–18 (1999) (arguing for maximization of the value of all financial claims of the corporation).

202. At the same time, because investors drive enlightened shareholder value, financial stakeholders whose

finance scholars have developed alternative measures of firm value that attempt to provide a more comprehensive picture of the corporation and might therefore offer better metrics to ground an ESV analysis.²⁰³

ii. Two-tier Constrained Optimization

Other possible rules, while not generally advanced by ESV advocates, are also consistent with an ESV approach. One possibility is a two-tier model where decisions that are expected to maximize long-term value to shareholders are first *identified*, and then from those, zero-sum options—that is, decisions that are viable only if high costs to stakeholders are presumed—are excluded.²⁰⁴ This rule might apply, for example, when weighing the business, political, and reputational risks associated with a planned foreign investment. Again, this approach would not, however, be appropriate in either the *Revlon* context²⁰⁵ or where the firm is insolvent²⁰⁶ and shareholders cease to have long-term interests in the firm's survival. Conceptually, a two-tier rule would essentially embody the principle that the corporation should “do no harm.” The challenge with this type of standard is that determining the long-term effect of any decision and then resolving inevitable conflicts between stakeholders (and shareholders) affected by the decision is inherently difficult. However, the corporation could use this approach as an initial decision tool to exclude those options that are reasonably likely to impose severe or widespread costs on one or more direct stakeholders of the firm.

interests may overlap less closely with those of shareholders (such as creditors) are not generally represented.

203. See generally Bennett Stewart, *EVA Momentum: The One Ratio That Tells the Whole Story*, 21 J. APPLIED CORP. FIN., no. 2, Spring 2009 at 74 (defining EVA Momentum); Terrance Jalbert et al., *EVA as a Predictor of Firm Performance*, 8 J. ACCT. & FIN. RSRCH., no. 3, at 83 (Winter 2000) (advocating economic value added (EVA) as a better measure of firm performance than traditional measures of earnings and cash flow). But see John M. Griffith, *The True Value of EVA*, 14 J. APPLIED FIN., no. 2, Winter 2004 at 25 (assessing the performance of companies that have implemented the EVA-based compensation system). See also Fisch, *supra* note 68 (surveying this literature and efforts to quantify costs and gains to stakeholder groups).

204. A rule which requires management to simultaneously maximize the welfare of all stakeholders (i.e., a Pareto optimal result) is not included, since even if it could be achieved, it would not be consistent with the enlightened shareholder value model's emphasis on shareholder value. See, e.g., Bebchuk, *Shareholder Power*, *supra* note 30, at 910 (“In theory, one could consider management to maximize the overall welfare of all corporate constituencies. Courts, however, would be unable to enforce effectively compliance with such a principle.”). Shareholders would likely face similar difficulty. The “balanced scorecard” approach, developed by Kaplan and Norton, might also be used to implement an enlightened shareholder value decision rule. See Robert S. Kaplan & David P. Norton, *The Balanced Scorecard—Measures That Drive Performance*, HARV. BUS. REV., Jan.–Feb. 1992, at 71–79. However, as Jensen points out, the Balanced Scorecard likewise does not provide a single objective standard for guiding how to weigh financial, customer, internal business process, learning and growth and other dimensions that together make up the “scorecard.” Jensen, *supra* note 55, at 17–21.

205. See *supra* text accompanying notes 73–76 (discussing *Revlon*).

206. Where the corporation is insolvent, creditors stand “in the place of shareholders as the residual beneficiaries of any increase in value.” *N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla*, 930 A.2d 92, 99, 101 (Del. 2007).

2. *Enlightened Shareholder Value Decision Rules Under Corporate Law*

All of these decision rules would pass muster under current Delaware corporate law and under most state corporate statutes.²⁰⁷ Moreover, investor-driven enlightened shareholder value requires no change in existing corporate governance rules. First, as we have seen, corporate directors and officers are not obligated by law to maximize shareholder wealth outside the narrow circumstances of a change in control under *Revlon*.²⁰⁸ Second, with regard to the control rules of corporate governance, enlightened shareholder value does not presuppose either a shareholder-primacy or director-primacy approach and is consistent with existing director-centric governance rules.

Certainly, in both the United States and the United Kingdom, enlightened shareholder value has emerged in a context that gives prominence to shareholder interests. An investor-oriented vision of enlightened shareholder value is also supported by trends toward greater board accountability to shareholders. However, investor activism around ESG risk and other stakeholder issues presumes that directors have the broad discretion afforded by current law to consider stakeholder interests. Moreover, disclosure of ESG risks and implementation of an enlightened shareholder value vision at the firm level depends on the initiative and leadership of corporate boards. As Elhauge observes, directors are well-positioned to bear direct responsibility for the corporations’ impact on stakeholders, since they possess inside information on corporate operations and directly bear the shame of public relations “sanctions.”²⁰⁹ Finally, in an era where more voices are weighing in on the direction of the corporation, there is clear value in preserving the board’s traditional role as a central decision maker with the power of “fiat,” as Bainbridge has urged.²¹⁰ While shareholder empowerment gives shareholders greater space to define corporate accountability, the fundamental balance of current law gives corporate boards the necessary freedom to balance competing interests and make decisions for the long-term benefit of the firm as a whole.

Enlightened shareholder value also poses no challenge to the current choice of the shareholder as the constituency that enjoys monitoring and enforcement rights under corporate law.²¹¹ Notwithstanding fears of some that proxy access will open the door for “constituency” directors, institutional investors have not pushed for stakeholders to have a direct voice in corporate affairs—for example, by giving employees a seat on the board, nor are they likely to urge that fiduciary duties, voting rights, or other shareholder privileges be extended to other stakeholders—even if state corporate codes and corporate

207. See generally *supra* Part III (discussing the role of stakeholders under corporate law).

208. *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986).

209. See Elhauge, *supra* note 72, at 800 (discussing the benefits of managerial discretion to sacrifice corporate profits).

210. See Bainbridge, *Director Primacy*, *supra* note 3 (discussing the means and ends of corporate governance).

211. This is in contrast to communitarian visions of corporate governance that would give multiple stakeholders direct voice in corporate affairs. Progressive corporate scholars have called for multi-stakeholder fiduciary duties that would obligate managers to weigh stakeholder and shareholder concerns in corporate decision-making. See generally LAWRENCE E. MITCHELL, *PROGRESSIVE CORPORATE LAW* (Lawrence E. Mitchell ed., 1995). See *supra* notes 84–86 and accompanying text (discussing shareholder preeminence under corporate law).

boards authorized them to do so.²¹² Unless this changes, stakeholders will not gain *direct* voice in firm governance. The primary impact of enlightened shareholder value, then, is to harness investor power to lend *indirect* force to stakeholder concerns.

B. Normative Advantages of Enlightened Shareholder Value

Although enlightened shareholder value implies decision rules that differ in some key respects from shareholder wealth maximization, it also offers strong normative advantages as a statement of the corporate purpose. The implications of enlightened shareholder value are potentially far broader than those presented here. Nonetheless, the following are areas where these contributions are most apparent.

1. Of Law and Markets

Normative arguments in favor of shareholder wealth maximization rest on two primary economic rationales. The first is that maximizing shareholder wealth increases the entire corporate pie, redounding to the benefit of all stakeholders.²¹³ The second is that the corporation's single-minded pursuit of profits generates the greatest welfare gains to society as a whole.²¹⁴ ESV decision rules revise these standard arguments in ways that address some of the limits of law and of markets better than pure shareholder wealth maximization.

One such limit concerns negative externalities. As Bainbridge explains, if—as is typically assumed—nonshareholders have a priority fixed claim on firm assets while shareholders have a residual claim, then shareholder wealth maximization only generates net benefits to nonshareholders in the absence of externalities.²¹⁵ However, where the firm takes a course of action that is relatively risky, “[t]he increased return associated with an increase in risk does not benefit nonshareholders because their claim is fixed,

212. Any such change could only be accomplished through a charter amendment initiated by the board. Such an amendment would be contrary to current state corporate code provisions, which limit these rights to shareholders, or in the exceptional case, to creditors. *See, e.g.*, DEL. CODE ANN. tit. 8 §§ 211–22 (2010) (discussing *shareholder* meetings, elections, voting, and notice rights). Note also that the U.K. Companies Act of 2006 does not extend direct monitoring or enforcement rights to stakeholders either. U.K. Companies Act of 2006, §§ 260–69, pt. 11 (affording members the right to enforce management fiduciary duties through derivative litigation).

213. In brief, the theory states that shareholder primacy compensates shareholders for bearing greater risk than fixed claimants with a priority claim, and thus gives ultimate control to those with the strongest interest in maximizing the surplus and thus the entire economic pie. Employees, creditors, and other stakeholders are generally assumed to be fixed claimants. *See* Hansmaan & Kraakman, *supra* note 14, at 449.

214. *See* EASTERBROOK & FISCHER, *supra* note 67, at 38 (stating that “maximizing profits for equity investors assists the other ‘constituencies’ automatically”); Jensen, *supra* note 55, at 11 (“200 years’ worth of work in economics and finance indicate that social welfare is maximized when all firms in an economy attempt to maximize their own total firm value.”). Other arguments rest on the identification of shareholders as the legal owners of the corporation. Although the shareholder-owner’s strong rhetorical appeal has brought it back into circulation in support of shareholder democracy, this view has already been assailed on a number of practical and theoretical grounds. *See, e.g.*, Lynn Stout, *Bad and Not-So-Bad Arguments for Shareholder Primacy*, 75 S. CAL. L. REV. 1189, 1190 (2002) (citing the shareholder ownership theory as “the worst[] of the standard arguments for shareholder primacy”); Fisch, *supra* note 68, at 648–50 (summarizing the ownership argument and its limits as a justification for shareholder primacy).

215. Bainbridge, *Director Primacy*, *supra* note 3, at 585 n.182 (but concluding that the externalities argument is overstated).

whereas the simultaneous increase in the corporation’s riskiness makes it less likely that nonshareholder claims will be satisfied.”²¹⁶ If, on the other hand, as Jensen and others have recognized, shareholders are not in fact the sole residual claimants of the firm—indeed, employees and local communities often are as well—then shareholder value alone is not coextensive with firm value.²¹⁷ Under either view the conclusion that shareholder wealth maximization increases firm value, and therefore social value, may not hold true.

Enlightened shareholder value offers a response to these challenges. ESV proponents assert, in essence, that maximizing firm value maximizes shareholder wealth, not the other way around.²¹⁸ As I have argued, such a decision rule is more likely to encourage firms to recognize and internalize risks to stakeholders than pure shareholder wealth maximization.²¹⁹ ESV’s emphasis on the need to account for broader stakeholder concerns also meshes better with empirical findings that gains to shareholders are often generated simply by wealth transfers from other stakeholders, thus resulting in little or no net gain to the firm.²²⁰ Finally, ESV implicitly asserts that even when shareholder and stakeholder interests diverge, the firm’s externalizing of some costs to multiple stakeholders may reduce long-term shareholder value and increase the level of risk assumed by the firm. Thus, even under a pure shareholder wealth maximization approach it may not be possible to maximize shareholder economic value when these factors are excluded from the analysis. ESV’s emphasis on the intersections of stakeholder interests and shareholder value therefore offers useful revisions of some of these standard rationales.

With regard to the argument that profit maximization is best for society as a whole, enlightened shareholder value also implies the inverse of the standard argument: companies that do good for society will do well in the market, a proposition that has some empirical support.²²¹ In addition, ESV implies that the public spillover benefits of firm operations may be offset by costs and risks to stakeholders that are neither adequately addressed under current law nor known to the markets.²²² In particular, the

216. *Id.*

217. In other words, some stakeholder claims are *not* fixed but are in fact residual. *See supra* text accompanying notes 199–202 (distinguishing shareholder value and firm value). Jill Fisch observes that if stakeholder interests cannot be assumed to be adequately protected by contract, a point addressed *infra*, then stakeholders are also residual claimants, and “[i]f nonshareholders can be residual claimants or corporate decisions can transfer value between stakeholders, then maximizing shareholder value is not the equivalent of maximizing firm value.” Fisch, *supra* note 68, at 659–60 (reviewing empirical support finding these conditions met as a matter of corporate practice).

218. *See supra* Part IV.B.2 (explaining the rationales behind ESG-oriented investing).

219. *See supra* Part IV.A (proposing decision rules compatible with enlightened shareholder value).

220. A number of studies show, for example, that the value to shareholders produced by a takeover is often offset by the losses to employees. *See, e.g.,* Andrei Schliefer & Lawrence H. Summers, *Breach of Trust in Hostile Takeovers*, in *CORPORATE TAKEOVERS: CAUSES AND CONSEQUENCES* 33 (Alan J. Auerbach, ed. 1988).

221. *See supra* notes 119–20 (surveying early empirical studies finding a positive correlation between corporate social performance and financial performance).

222. In contrast to the standard argument that shareholder wealth maximization produces the greatest social welfare, ESV also acknowledges explicitly that nonshareholders’ interests in increasing firm value may not be coextensive with shareholder interest in profit-maximization and may thus deserve separate consideration. *See* Chen & Hanson, *supra* note 53, at 47 (“[The claim that increased firm value increases social welfare] assumes that the interests of nonshareholders are aligned with those [profit-maximizing interests] of shareholders.”).

emphasis of ESV proponents on environmental, social, and even human rights risks highlights the inadequacy of legal and contractual protections for involuntary stakeholders (i.e., employees of foreign suppliers, the environment, and distant tort claimants) and for other stakeholders of global corporations beyond the jurisdictional reach of U.S. law and courts.²²³ Pressure from investors, among others, may help fill these gaps.

2. *The Nature of the Corporate Contract*

A further normative argument in favor of shareholder wealth maximization and other dimensions of shareholder primacy is that it is an implied term of the hypothetical and real contracts between the firm and its various constituencies. Because shareholders lack the legal and contractual protections available to other stakeholders, so the argument goes, they would not agree to invest in long-term, capital-intensive projects of the firm if shareholder primacy were not part of the corporate contract (or would do so only at a higher rate of return).²²⁴ Assuming here the theoretical utility of a nexus of contracts understanding of the firm, it can at least be said that enlightened shareholder value implies a revision of the corporate contract argument that is a better fit with the emerging realities of global public corporations.

That shareholder wealth maximization is an assumed term of the contract is generally justified on grounds that shareholders are relatively powerless to defend their own interests, that nonshareholders are adequately protected by law or contract, and finally, that the rule is the one most likely to maximize firm value and is therefore the rule that the contracting parties would have reached had they explicitly bargained for it.²²⁵ However, while legal and contractual protections may be adequate protection for many stakeholders, we have already seen that they do not generally extend to many stakeholders of global corporations. With the rise of powerful institutional investors and lower barriers to shareholder activism, the claim that shareholders are in need of particular protection under corporate law has also lost some of its rhetorical force.²²⁶

223. These include foreign communities and workers who cannot be presumed to be protected by law, the democratic process, or even, an implicit contract. Because most corporate law scholarship assumes that corporations operate within a (single) democratic political system that can be relied on to address distributional and equitable effects generated by the market, the limits of international law in extending such protections globally are rarely considered. For a thorough discussion of the problem, see generally Cynthia Williams, *Corporate Social Responsibility in an Era of Economic Globalization*, 35 U.C. DAVIS L. REV. 705 (2002). See also Elhauge, *supra* note 72, at 803–04 (noting the limits of law as a constraint on corporate conduct, in part because “variations in legal regulation among different nations . . . inevitably leave legal gaps requiring supplementation by social and moral sanctions that operate internationally”).

224. See, e.g., Bainbridge, *Director Primacy*, *supra* note 3, at 600. See also EASTERBROOK & FISCHEL, *supra* note 67, at 36 (positing that shareholders as residual claimants implicitly contract for the promise that the firm will maximize long term returns to shareholders).

225. See Chen & Hanson, *supra* note 53, at 52–66 (“[S]cholars have offered a seemingly watertight set of arguments for why [the privileged] constituency should be shareholders. . . . (1) [O]ther stakeholders don’t need the protection of corporate managers and corporate law, (2) shareholders do; and in any event, . . . (3) the pressures that product markets, capital markets, and labor markets create constrain[] directors and managers, eliminating any discretion to pursue the interests of nonshareholder constituencies.”) (citations omitted). The Delaware courts have held specifically that creditors are limited to the protection of contract and regulatory rights. See, e.g., *N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla*, 930 A.2d 92, 99 (Del. 2007).

226. The choice of the shareholder as the stakeholder to whom corporate law grants monitoring and

Moreover, it is no longer certain that pure shareholder wealth maximization that excludes stakeholders is the decision standard that all shareholders would inevitably reach with other corporate stakeholders and firms. Indeed, many investors are, through various forms of activism, explicitly negotiating the terms of their continued investment directly with portfolio firms to ensure that the corporation generates solid returns but *also* gives due consideration to ESG issues.²²⁷ Traditional theories maintain that investors would demand a risk *premium* on their investment—that is, a higher rate of return—if managers were free to “make tradeoffs” between shareholders and stakeholders.²²⁸ However, the behavior of ESV-oriented investors and their allies among social investors suggests that, at least for them, the traditional assumption does not fit. Rather, these shareholders have concluded that firm-level risks are actually *reduced* when management takes both voluntary and involuntary stakeholders into account and that it is in fact *failure* to make some tradeoffs preferencing stakeholders that might increase long-term risks to shareholders, justifying a risk premium.

3. Of Means and Ends

Finally, traditional shareholder wealth maximization assumes that the *ends* of the corporation (i.e., advancing the private, economic interests of shareholders) can be distinguished from the choice of appropriate *means* to achieve that goal, a task which is left to management discretion, constrained, if necessary, by laws passed by duly elected public officials.²²⁹ However, given the reputational risk of “irresponsible” business practices, shareholder economic interests are increasingly directly linked to the economic and even non-economic interests of stakeholders. Enlightened shareholder value better recognizes that it is perhaps no longer possible to make useful distinctions between the private and public roles of the firm.

From a theoretical standpoint, the normative benefits of maintaining the means/ends and public/private distinctions underlying the shareholder wealth maximization norm will likely remain the subject of debate. Nonetheless, the range of issues raised through various forms of shareholder activism shows clearly that many shareholders are in fact as concerned about the *means* by which shareholder value is achieved as they are in returns on investment.²³⁰ Enlightened shareholder value thus also better comports with the observed reality that shareholders increasingly expect corporations to be directly accountable for *how* their money is spent.

enforcement rights may, however, still be justified on grounds that shareholders’ interests are generally speaking most closely aligned with the interests of all of the firm’s stakeholders.

227. As Einer Elhauge notes, “maximizing shareholder welfare is not the same thing as maximizing shareholder profits,” in part because many shareholders derive nonfinancial benefits from socially and morally desirable corporate activities. Elhauge, *supra* note 72, at 783–96. Although ESV-oriented investors generally demand returns on investment that meet or exceed market levels, the level of return on investment that shareholders are willing to sacrifice in exchange for these nonfinancial benefits will inevitably vary.

228. Bainbridge, *Director Primacy*, *supra* note 3, at 600.

229. *See, e.g.*, Friedman, *supra* note 61 (arguing that corporate officers should not improperly assume a public role by promoting social responsibility, and affirming the importance of law and ethical norms in constraining executives’ conduct).

230. Shareholder proposals seeking to set limits on executive compensation, and social proposals urging, for example, disinvestment from Sudan, illustrate this point equally. Both reflect investor concerns about the means by which firm success is achieved.

4. Stakeholder Representation

This Article has argued that many stakeholder interests are compatible with the economic interests of shareholders and the corporations they invest in. The following subpart addresses the challenges raised by areas in which those interests may not be so aligned. However, assuming those arguments prove convincing, further normative objections might still be raised about whether investor advocacy of stakeholder interests is in fact good for stakeholders and if so, whether investors are in fact better positioned than regulatory authorities, corporate boards, or stakeholders themselves, to advance and protect stakeholder interests.

While there is not space here to provide a complete response to this question, a few observations are in order. First, it is doubtful that indirect representation by institutional shareholders fully and accurately reflects the true interests of stakeholders. What is material to a given stakeholder constituency, even from a strictly economic standpoint, may not be material to the firm or to large portfolio investors. Second, because any voluntary ESV approach inevitably gives institutional investors and corporate directors and officers the power to define, select, and prioritize the stakeholder interests they will advance, investors and boards are inevitably framing how stakeholder interests are perceived by corporate managers and which will be deemed “material.” Particularly for financial stakeholders, such as creditors and to a lesser extent employees, investor voice will generally be an imperfect substitute for direct protections that may be provided through contract, protective legislation, or direct stakeholder engagement with firm management. Nonetheless, shareholders *can* and do advance certain stakeholder interests, and investor advocacy can amplify stakeholder voice where these mechanisms are weak.

This is particularly so in the case of “involuntary” stakeholders—such as the environment, foreign workers, and victims of human rights violations—for whom regulatory and contractual mechanisms may not be available or enforceable. Even if domestic, foreign, and international regulation is strengthened, “one-size-fits-all” approaches will inevitably be imperfect and in many cases, unenforceable. For these stakeholders, investor activism that motivates firms to “self-regulate” by identifying and reducing risks and harms to these constituencies can provide an important supplement to market pressure from NGOs and consumers and reinforce existing contractual and regulatory protections.²³¹

C. Enlightened Shareholder Value & The “Problem” of Stakeholders: Responding to Efficiency-based Concerns

Since Berle and Dodd began their famous debate over the nature and purpose of the corporation, any significant movement within academic and popular discourse in the direction of shareholder primacy has caused an equal and opposite movement away from the stakeholder model and its emphasis on corporate obligations to broader constituencies.²³² Not surprisingly, one can chart the ebb and flow of the corporate social responsibility movement itself along much the same historical trajectory.²³³ Over the past

231. On corporate self-regulation see generally PARKER, *supra* note 189.

232. See generally Chen & Hanson, *supra* note 53 (tracing the history and origins of the debate).

233. See Branson, *supra* note 15 (tracing the history of corporate social responsibility in relation to

decade, however, the lines between these categories have begun to blur.²³⁴ Enlightened shareholder value promises to dissolve some of the remaining boundaries, paving the way toward more integrated conceptualizations of the corporation and its purpose. Where then does enlightened shareholder value leave us in considering the "problem" of stakeholders that is behind much of the debates over corporate governance reform?

1. "Too Little" Attention to Stakeholders

The first area of concern is that shareholder power might cause management to give too little attention to stakeholders. This Article suggests that such assumptions are no longer well-founded. As Part IV of this Article highlights, "enlightened shareholder value" is in fact already gaining traction among influential mainstream institutional investors and might ultimately motivate leading public corporations in a pro-stakeholder direction. These trends support findings from Lisa Fairfax's survey of investor social activism, which provides ample evidence that many institutional investors can and do advocate for stakeholders.²³⁵ More comprehensive reporting and disclosure of ESG and other nonfinancial factors may also facilitate broader public oversight of corporate activities that affect stakeholders.

2. "Too Much" Attention to Stakeholders

Expanded shareholder influence is, however, problematic for those concerned about the potentially efficiency-reducing effects of shareholder representation of stakeholder interests. The ESV model responds in part to these concerns by showing that accounting for stakeholders in investment and ultimately managerial decision making can generate long-term shareholder wealth. Thus, efficiency-based rationales at both the investor and the firm levels actually ground enlightened shareholder value, which has the potential to make headway in the mainstream investment and business communities precisely for that reason.

Still, it might be argued that ESV decision rules, like other stakeholder-oriented decision rules, are nonetheless efficiency-reducing because they give "too much" attention to stakeholders. Essentially, the arguments are that stakeholder-oriented rules: (i) lack the practical simplicity of a single maximand, exacerbating agency problems (the "two masters" problem); and (ii) directly or indirectly advance "private," political, or social interests that distract from the mission of the firm. These important criticisms have been reinvigorated in the course of the shareholder empowerment debate, and are ones to which enlightened shareholder value offers a more satisfying response than pure stakeholder models.²³⁶

corporate governance).

234. See, e.g., Stout, *supra* note 80 (identifying some of these trends).

235. See generally Fairfax, *Shareholder Democracy*, *supra* note 17.

236. Stakeholder-oriented theories generally maintain that the interests of shareholders and other stakeholders should be weighed equally in managerial decision making or that other stakeholder interests, such as those of employees, should take precedence. For a survey of stakeholder theories, see Thomas Donaldson & Lee E. Preston, *The Stakeholder Theory of the Corporation: Concepts, Evidence, and Implications*, 20 ACAD. MGMT. REV. 65 (1995).

a. A Response to the “Two Masters” Problem

The strongest argument for the shareholder wealth maximization norm is that it keeps corporate managers accountable to shareholders by setting a single clear standard—maximizing shareholder wealth, as reflected in the share price. Conversely, one of the strongest criticisms of pro-stakeholder theories is that they leave managers without a standard for choosing among competing stakeholder interests. This multiplicity of interests provides a cover for management self-interest, which is the essence of the “two masters” problem.²³⁷ In the words of Easterbrook and Fischel

a manager told to serve two masters (a little for the equity holders, a little for the community) has been freed of both and is answerable to neither. Faced with a demand from either group, the manager can appeal to the interests of the other. Agency costs rise and social wealth falls.²³⁸

Enlightened shareholder value, like shareholder wealth maximization, overcomes these obstacles by placing creation of long-term shareholder value as the single objective standard.²³⁹ However, ESV-oriented investors expect management decision making to satisfy an *additional* criterion—that is, to be justified with reference to stakeholders, whether by avoiding harms to stakeholders that pose a material risk of future loss to the firm, or by seeking opportunities to generate wealth in a way that also benefits stakeholders.²⁴⁰ Such a decision rule raises no greater practical difficulties than in the current context of corporate decision-making, where managers routinely confront demands from competing shareholder and stakeholder constituencies. Moreover, even when internalizing costs to stakeholders means that the firm foregoes some increase in the level of profits it would otherwise have enjoyed (and is therefore to some extent profit-sacrificing), agency costs cannot be assumed to rise inevitably.²⁴¹ As Einer Elhauge has observed, managers are effectively restrained by market forces and social and moral sanctions from excessive profit-sacrificing behavior—in other words, there are limits on agency slack.²⁴² Accordingly, profit-sacrificing decisions made in the “public interest” can actually reduce the type of self-interested, profit-sacrificing behavior that is at the heart of the “two masters” critique.²⁴³

237. *Id.* See also Bebchuk, *Shareholder Power*, *supra* note 30, at 910–11.

238. See EASTERBROOK & FISCHEL, *supra* note 67, at 38.

239. See Bainbridge, *Director Primacy*, *supra* note 3, at 600 (explaining that under shareholder wealth maximization, “if the board considers the interests of nonshareholder constituencies when making decisions, it does so only because shareholder wealth will be maximized in the long run”). *But see* Blair & Stout, *supra* note 29, at 304 (disputing this view based on evidence from the takeover context).

240. This is an advantage of Jensen’s “enlightened stakeholder model” as well. See Jensen, *supra* note 55, at 9 (arguing that “to maximize firm value, managers must not only satisfy, but enlist the support of, all corporate stakeholders”).

241. See, e.g., *supra* note 194 and accompanying text (discussing primacy mechanisms for motivating firms to internalize agency costs).

242. Elhauge, *supra* note 72, at 805–14, 846–47 (noting that there is also no legal prohibition on such an exercise of managerial discretion).

243. *Id.*

b. A Response to the Problem of Private Interests

The question of “private” or “special” interests poses more difficulty for an enlightened shareholder paradigm. Here, the basic concern is that the most activist shareholders, namely, large public pension funds, union funds, and hedge funds (which, with the exception of hedge funds, are also among the foremost advocates of an enlightened shareholder value approach) might use their power to advance their own private, political, or constituency interests, transferring value from other shareholders or stakeholders to select shareholders.²⁴⁴ Shareholders might also align with management against stakeholders for reasons not shared by the shareholder class.²⁴⁵ Both concerns resonate strongly with critics of greater shareholder power.

At the outset, we should dispel the false notion that these problems do not arise under shareholder wealth maximization. Since shareholder voice is now a part of the landscape in which public corporations must operate, then the artificial uni-dimensional wealth maximizing shareholder has already been replaced by a heterogeneous, dynamic contingent of mostly fiduciary shareholders, who together with their beneficiaries, have real and diverse interests that include, but may extend beyond wealth maximization.²⁴⁶ Therefore, the assumption that all shareholders are long-term wealth maximizers is now less theoretically and practically useful. While courts may continue to rely on this fiction for its simplicity,²⁴⁷ shareholder voice clearly means that what real investors want, in all its variety, matters both to management and to other shareholders who likely will have quite different views.

The enlightened shareholder value approach does not itself resolve all of these challenges. It cautions, however, that shareholder activism that aligns with stakeholders or that constrains the *means* of generating profits should not be suspect as per se “impermissible.” Specifically, the fact that public pensions, labor union funds, and other activist institutional investors owe duties to diverse constituencies with both economic and non-economic goals does not necessarily present a threat to long-term value creation. While further empirical research on the impact of ESV-oriented investing, for example, under the rubric of the PRI, on firm behavior is needed,²⁴⁸ ESV-oriented investor activism has the potential to encourage companies to pursue *value-increasing* environmental and social goals that they might otherwise neglect, or *deter* activities that create a high risk of harm to other stakeholders that may ultimately be value-decreasing for the firm. Therefore, discouraging institutional investor voice on “public” or

244. See, e.g., Anabtawi & Stout, *supra* note 17, at 1285–86 (citing CalPERS proxy campaign to oust Safeway’s president and pressure Safeway in labor negotiations).

245. See *supra* note 51 (discussing these concerns).

246. For the most comprehensive treatment of the fictional wealth-maximizing shareholder, see Daniel J.H. Greenwood, *Fictional Shareholders: For Whom Are Corporate Managers Trustees, Revisited*, 69 S. CAL. L. REV. 1021 (1996). However, the heterogeneity of even the *economic* interests of shareholders challenges the traditional view that a single maximand can be achieved by relying on trends in share prices. Anabtawi, *supra* note 51, at 575.

247. See Greenwood, *supra* note 246, at 1025–26, 1058–65 (referring to the shareholder wealth maximizing shareholder as a “legal fiction” and demonstrating its reflection in case law).

248. For a survey of recent empirical findings on the impact of SRI and ESV-oriented investing on various measures of corporate performance, see MERCER, *SHEDDING LIGHT ON RESPONSIBLE INVESTMENT* (Nov. 2009) (available by subscription).

“stakeholder” issues because it may be a cover for self-interest, collusion, or managerial protectionism runs the risk of throwing the baby out with the bathwater, resulting in lost benefits to stakeholders and shareholders as well. Instead, it is possible to leave space for enlightened shareholder value by narrowing the class of “private” interests that pose concern.

There are essentially two forms of “impermissible” (i.e., value-decreasing) private interests: *self-interest* (rent-seeking, opportunism, and “hold-up”) and *collusion with management* (“gang-up”). Activism conducted for these purposes is impermissible not because it might advance the interests of labor unions or the agenda of a prominent environmental NGO, but because it confers a unique *economic* benefit on the activist that is not shared by the shareholder class.²⁴⁹ It is reasonable to assume that the motivations of ESV proponents, like other investors, will not be uniform. However, because enlightened shareholder value focuses on wealth-enhancing corporate reform and advancing broader definitions of corporate accountability, ESV-oriented investors should generally oppose misuse of activist power for solely “private” or “special interest” purposes.

A full analysis of potential solutions is beyond the scope of this Article. However, a number of possibilities have already been proposed that would mitigate these risks and allow firms (and markets) to reap the benefits of value-enhancing investor activism. First, the majority voting rule already offers some protection against impermissible activism. Although majority voting will not necessarily prevent all abuses of shareholder power,²⁵⁰ it clearly does deter some degree of self-interested activism. The deterrent effect is arguably stronger when investors are engaging in direct social activism, since social proposals historically have attracted less support from non-proponent investor groups.²⁵¹ For example, recent studies of “say-on-pay” shareholder proposals have found that labor-union-initiated proposals targeting firms where CEO pay was not in fact excessive generally received lower support from other shareholders.²⁵²

Other proposals that offer strong potential deterrents for impermissible activism would extend controlling shareholder fiduciary duties to all activist shareholders,²⁵³ or strengthen the transparency and accountability of fiduciary institutions, such as pension funds, to fund beneficiaries and other stakeholders. Such measures might include

249. Anabtawi and Stout’s arguments in favor of fiduciary duties for activist shareholders make the same distinction. Anabtawi & Stout, *supra* note 17, at 1284.

250. See Anabtawi, *supra* note 51, at 593–97 (illustrating how binary shareholder voting is not a reliable way to produce outcomes that increase shareholder value when shareholders have private interests).

251. See Buchanan, *supra* note 25, at 5; Fairfax, *supra* note 17, at 58–59.

252. Jie Cai & Ralph A. Walkling, *Shareholders’ Say on Pay: Does it Create Value?*, J. FIN. & QUANT. ANAL. (forthcoming 2010) (manuscript at 5–6), available at <http://ssrn.com/abstract=1030925>. See also Yonca Ertimur et al., *Shareholder Activism and CEO Pay* (unpublished manuscript) (manuscript at 2–4), available at <http://ssrn.com/abstract=1443455> (concluding based on similar findings that union pension funds are not more likely to target unionized firms or firms with labor-related negotiations but that “shareholders have judiciously used their voting power” with respect to say on pay). Labor union funds also typically oppose management-sponsored director nominees and executive compensation plans, according to one study of proxy voting by AFL-CIO pension funds. See Yermack, *supra* note 23, at 18 (citing A.K. Agrawal, *Corporate Governance Objectives of Labor Union Shareholders: Evidence from Proxy Voting* (NYU Working Paper Series No. Fin-08-006) (2008)).

253. See Anabtawi & Stout, *supra* note 17, at 1294–1303; Rose, *supra* note 51, at 46–49.

expanding beneficiary roles in pension fund governance or requiring institutional investors and/or management to publicly disclose activists' identity, conflicts of interest, their motivation and means of exercising activism, and possibly, the substance of any negotiations between the company and the activist.²⁵⁴ The recent enactment of new Rule 14a-18 under the Securities Exchange Act of 1934, which requires disclosure regarding shareholder nominees and the nominating shareholder or group,²⁵⁵ and new disclosures required for institutional investment managers under the "say on pay" provisions of new Section 14A of the '34 Act,²⁵⁶ are efforts to implement some of these recommendations and represent positive steps toward greater transparency of shareholder activism.

Further answers also lie in where the boundaries for shareholder activism have been and may be set in the course of ongoing corporate governance reforms. Limits to proxy access, for example, such as ownership stake requirements, limits on the number of "access" seats, and the mandatory disclosure rules for proponents of access candidates described above, which have been recently adopted by the SEC reflect a measured approach that if ultimately successful should alleviate some of the objections to investor-driven enlightened shareholder value raised earlier.²⁵⁷ The need to address shareholder heterogeneity and conflicts of interest also points ultimately to the value of maintaining the fundamental director-oriented control rules, such as a strong business judgment rule, as an important safeguard against impermissible uses of shareholder power, even as investors serve as a check on managerial self-interest. In light of these rules and the availability of targeted solutions to the types of activism that pose concern, one should not view the fact that shareholders may use their power to advance the interests of stakeholders as inherently problematic from an efficiency standpoint.

VI. CONCLUSION

The global financial crisis has produced profound skepticism about the power of markets to right all wrongs and has renewed interest in the tools of public regulation. But, as Mark Roe observed over a decade ago, there is reason to doubt that legal change alone will lead to structural or institutional change in the actors and relationships that are entrenched in the economy.²⁵⁸ What is interesting about the present moment is the confluence of market and regulatory changes that has given investors greater influence in corporate governance. Equally interesting is that leading institutional investors are

254. See Rose, *supra* note 51, at 50–59; DAVIS, *supra* note 112, at 140–73 (considering increased fiduciary disclosure requirements, "pass-through" proxy voting, beneficiary nomination of pension trustees, and other measures to increase beneficiaries' monitoring). See also Keith T. Johnson & Frank Jan de Graaf, *Modernizing Pension Fund Legal Standards for the Twenty-First Century*, 2 ROTMAN INT'L J. PENSION MGMT. 46 (2009) (advocating pension fund governance reforms, including increased reporting requirements, greater beneficiary representation on fund boards, external audits of practices to avoid conflicts of interest, and reporting of efforts to align fund manager incentives with beneficiaries' long-term interests).

255. 17 C.F.R. § 240.14a-18. See also Regulation 14N, 17 C.F.R. § 240.14n (requiring disclosures on Schedule 14N of a proponent's intent to nominate a director candidate under Rule 14a-11).

256. Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, 124 Stat. 1376 (July 21, 2010), § 951.

257. See Facilitating Shareholder Director Nominations, *supra* note 40.

258. ROE, *supra* note 16, at 275 (positing that "[l]egal change alone might not lead to structural change" in long-standing ownership and governance structures given economic, political, and institutional forces that favor the status quo).

beginning to use their power to advance stakeholder-oriented approaches to accountability, risk management, and governance that challenge conventional understandings of corporate accountability.

As we have seen, enlightened shareholder value represents just such an alternative vision and one that offers theoretical and normative advantages over the shareholder wealth maximization norm. It also offers principled responses to many of the concerns surrounding shareholder empowerment and rising shareholder activism. Recent regulatory initiatives at the state and federal levels, such as efforts to improve disclosure of corporate risk management policies, clarify standards for corporate non-financial reporting, make institutional investor activism more transparent to fund beneficiaries, and discourage short-termism across the financial services industry may well move corporations more quickly in this direction. This Article has considered some of the implications of such a shift for managerial decision making and suggested intersections between enlightened shareholder value and emerging corporate governance rules.

Yet whether regulatory changes lend support or not, investor-driven “enlightened shareholder value” shows that the practice of corporate governance has already moved beyond the shareholder–stakeholder divide. The challenge for future corporate governance reform and scholarship is now how best to optimize the contributions of stakeholders, shareholders, and corporate boards to firm success in light of this reality. How this balance will ultimately be set for public corporations remains to be seen. But if the ascendancy of shareholder primacy itself is any guide, emerging market-driven norms like enlightened shareholder value might ultimately shape the “rules of the game” for corporations as much or more than positive legal rules.