

*Materials for the AALS 2005 Annual Meeting Workshop on Democratic Governance:
Session on Elections and Shareholder Participation in the Selection of Corporate Boards*

MAYBE SHAREHOLDERS DON'T WANT DEMOCRACY

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Abstract

By the late 1990s, many scholars and regulators had come to believe U.S. corporate law embraces a “shareholder primacy” model that holds that shareholders should enjoy ultimate control over public corporations and that corporate directors should seek to maximize shareholder wealth. This view is mistaken both positively and normatively.

As a positive matter, U.S. corporate law and practice does not give shareholders control of public corporations and does not require directors to maximize shareholder wealth. To the contrary, corporate law and practice grant directors a wide range of discretion, constrained only at the margin by market forces, to sacrifice shareholder wealth in order to benefit other constituencies.

As a normative matter, at least five lines of thought have emerged in modern corporate scholarship that independently suggest why the resulting “director primacy” may be desirable from shareholders’ own perspective. Both individually and taken together, these five lines of theory explain why U.S. law does not in fact follow the shareholder primacy model. They also suggest why shareholders themselves, as a class, prefer ex ante that public firms be governed by boards of directors that are not required to maximize shareholder wealth.

OUTLINE OF ARGUMENT

The Conventional Theory: The Old “Shareholder Primacy” Model

- Shareholders “own” the corporation
- Shareholders are sole residual claimants who get all profits—other stakeholders get contractual minimum
- Shareholders are “principals” who hire directors as “agents” to do the shareholders’ bidding
- Shareholders would prefer more power over directors to less
- The corporate goal is to maximize shareholder wealth as measured by share price

The Facts on the Ground: Shareholders Are Subject To and Seem to Prefer “Director Primacy” in Public Firms

- The corporation is an independent legal entity that “owns” itself
- Shareholders are one of many potential residual claimants—others include employees, customers, creditors, even the community
- Directors are not agents but fiduciaries who are legally free to refuse a unanimous shareholder command and who owe duties to both shareholders *and* “the firm”
- Shareholders use the enabling nature of corporate law to weaken their own power
- The corporate goal is the firm’s survival, and, secondarily, growth

Reconciling Theory And Fact: Five Theories of Why Director Primacy Serves Shareholders (With A Partial Bibliography)

--On The Inaccuracy of Stock Prices:

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--On Capital Lock-In:

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Henry Hansmann and Reinier Kraakman, *The Essential Role of Organizational Law*, 110 Yale L. J. 387 (2000).

--On Team Production:

Margaret M. Blair and Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 Va. L. Rev. 247 (1999)

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--On the Universal Shareholder:

Robert A.G. Monks, *THE NEW GLOBAL INVESTORS* (2001).

James P. Hawley and Andrew T. Williams, *THE RISE OF FIDUCIARY CAPITALISM* (2000)

--On the Social Investor:

Cynthia William, *The Securities Exchange Commission and Corporate Social Transparency*, 112 Harv. L. Rev. 1197 (2000).

Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest* (Harvard Law School, Draft of August 17, 2004)