CORPORATE SOCIAL RESPONSIBILITY THROUGH SHAREHOLDER GOVERNANCE

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ABSTRACT

New approaches to corporate purpose have emerged in recent years that hold out the promise of addressing concerns about corporate social responsibility ("CSR") through shareholder governance, rather than in spite of it. The seminal such approach—enlightened shareholder value—posits that treating other stakeholders well can ultimately redound to long-term shareholder value. However, two more recent proposals reconceptualize shareholder interests in more holistic ways and urge that it is shareholders' welfare, not shareholder value per se, that managers should pursue. In particular, the "shareholder social preferences" view incorporates into the corporate objective the degree to which the firm's operations align with the social views of shareholders. The "portfolio value maximization view," in contrast, argues that corporate fiduciaries should maximize the value of diversified shareholders' portfolios by considering the externalities of the firm's operations on those portfolios.

Shifting to shareholder welfare as the corporate objective, however, would do little to improve corporate conduct and would entail substantial costs. The social preferences of shareholders are conflicted, muted, and

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often prefer less protection of stakeholder interests than provided by law. Shareholders' portfolio value captures only a small portion of the externalities like pollution that its proponents hope to address and risks motivating anticompetitive conduct. And neither corporate managers nor shareholders would have the information and incentives needed to pursue these additional shareholder welfare considerations. On the contrary, by distracting management from their core competencies, shareholder welfarism would ultimately lower shareholder welfare.

The future of CSR, as with its past, is instead with enlightened shareholder value ("ESV"). But the existing law-and-economics literature on ESV has been stunted by key misconceptions, which we attempt to dispel. The increasing use by various actors in the corporate system of normative arguments that sound in ESV terms may lead to new pathways for achieving social progress.

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INTRODUCTION

Corporate managers play crucial roles in our society, sitting as they do atop organizations in control of vast agglomerations of resources. A long-standing debate in American law concerns how corporate fiduciaries should conceive of their jobs—what objective should they pursue? The traditional understanding is that the fiduciaries of a business corporation should pursue shareholder value, and much of our corporate governance system is designed to that end. Pursuit of shareholder value, of course, can conflict with other interests in society. The classic alternative to the shareholder value maximization paradigm is some form of stakeholderism, in which shareholder wealth is but one of the ends to be sought by management, alongside the interests of workers, other suppliers, customers, and the broader community.

But stakeholderism has foundered due to two key problems. First, state corporation statutes give shareholders the right to elect the board of directors, which in turn holds legal power to manage the corporation.[1] Directors are naturally oriented toward serving the interests of their equity investor electorate, so that absent deeper reforms that would give other stakeholders board representation, shareholders' interests are likely to continue to be treated as primary.[2] Second, stakeholder theorists have not congealed around

1. *See, e.g.*, DEL. CODE ANN. tit. 8, §§ 141(a), 211(b) (2023).
2. Leo E. Strine, Jr., *Corporate Power Is Corporate Purpose I: Evidence from My Hometown*, 33

any methodology to determine how corporate management should strike the inevitable trade-offs among the competing interests of different stakeholders, simply leaving it up to management to sort out as they see fit.[3] Lacking any metric against which management performance can be judged, stakeholderism in practice risks reducing the accountability of management.[4]

The debate about corporate purpose is old, dating back at least as far as the foundational exchange between E. Merrick Dodd Jr. and A.A. Berle Jr. in the pages of the *Harvard Law Review* in the early 1930s.[5] Yet as early as that era, there were those who questioned the extent to which shareholder interests are actually incompatible with stakeholder interests. Mistreating workers, customers, and other firm patrons is not in general a recipe for long-term business success.[6] As Dodd himself put it, "No doubt it is to a large extent true that an attempt by business managers to take into consideration the welfare of employees and consumers . . . will in the long run increase the profits of stockholders."[7] While not embraced by Dodd,[8] this so-called "enlightened" shareholder value view has historically represented the primary alternative to stakeholderism for those seeking to reorient corporate managers toward more socially responsible business practices.[9]

But recent years have given rise to new perspectives on how corporate managers should understand shareholders' interests that aim to weaken the grip of shareholder value on the hearts and minds of corporate managers and

OXFORD REV. ECON. POL'Y 176, 179 (2017); Lucian A. Bebchuk & Roberto Tallarita, *The Illusory Promise of Stakeholder Governance*, 106 CORNELL L. REV. 91, 146 (2020); Edward B. Rock, *For Whom Is the Corporation Managed in 2020?: The Debate over Corporate Purpose*, 76 BUS. LAW. 363, 394 (2021).

3. Margaret M. Blair & Lynn A. Stout, *Director Accountability and the Mediating Role of the Corporate Board*, 79 WASH. U. L.Q. 403, 408 (2001).

4. FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 38 (1991); Michael C. Jensen, *Value Maximization, Stakeholder Theory, and the Corporate Objective Function*, 14 J. APPLIED CORP. FIN., Fall 2001, at 8, 14 (2001) ("By failing to provide a definition of better [and worse decision-making], stakeholder theory effectively leaves managers and directors unaccountable for their stewardship of the firm's resources.").

5. *See generally* E. Merrick Dodd, Jr., *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145 (1932); A.A. Berle, Jr., *For Whom Corporate Managers Are Trustees: A Note*, 45 HARV. L. REV. 1365 (1932).

6. Jensen, *supra* note 4, at 16 ("[I]t is a basic principle of enlightened value maximization that we cannot maximize the long-term market value of an organization if we ignore or mistreat any important constituency." (emphasis omitted)).

7. Dodd, *supra* note 5, at 1156.

8. *Id.* at 1156–57 ("[O]ne need not be unduly credulous to feel that there is more to this talk of social responsibility on the part of corporation managers than merely a more intelligent appreciation of what tends to the ultimate benefit of their stockholders.").

9. *See* Dorothy S. Lund, *Enlightened Shareholder Value, Stakeholderism, and the Quest for Managerial Accountability* in RESEARCH HANDBOOK ON CORPORATE PURPOSE AND PERSONHOOD 91, 94–99 (Elizabeth Pollman & Robert B. Thompson eds., 2021) (documenting embrace of ESV among corporate managers and investors).

provide a new north star by which they could chart a more socially responsible course. The key to these innovations is the recognition that the shareholders of a business corporation in general care about more than just the return on the company's common stock. For one, shareholders care about other stakeholders' interests directly because of their own personal normative commitments (their "social preferences," in the reductive parlance of economists). And even from just a financial perspective, each shareholder's stake in the company is held as part of a broader portfolio. Some portion of the external harms that arise as by-products of the company's pursuit of profits—to the environment, for example—will ultimately fall on other companies held in shareholders' portfolios. Under this view, for corporate fiduciaries to further shareholders' true interests, properly understood, they must eschew narrow shareholder value maximization and instead focus on shareholder *welfare* maximization, which incorporates these shareholder social preferences and portfolio effects.

In this Article we provide the first comprehensive analysis of these attempts, new and old, to pursue corporate social responsibility through shareholder governance. In Part I, we provide a brief overview of the traditional debate about the objective of a business corporation. In Part II, we dilate on the idea of enlightened shareholder value ("ESV") as a way to pursue corporate social responsibility ("CSR") within the traditional norm of shareholder primacy. In Part III, we outline the more recent attempts to improve corporate conduct by incorporating more holistic understandings of shareholder interests, one that focuses on shareholders' social concerns and another that considers shareholders' financial interests from a diversified portfolio perspective, which we refer to as the shareholder social preferences ("SSP") view and the portfolio value maximization ("PVM") view, respectively.

In Part IV, we turn to evaluating the extent to which these three competing approaches to pursuing CSR through shareholder governance—ESV, SSP, and PVM—are likely to induce public companies to incur costs on a voluntary basis in ways that further the interests of other stakeholders in the firm. We refer to such actions as engaging in CSR. We begin by analyzing the degree to which the corporate objective posited by each approach captures CSR concerns, ignoring the challenges to inducing managers to pursue each objective. While the long-term shareholder value objective of ESV does align to some extent with key stakeholder concerns, it falls short of resolving all social conflicts about corporate conduct, even if we put feasibility concerns to the side. But incorporating shareholders' social preferences into the corporate objective offers little hope for improvement. For one, shareholder welfare puts far greater relative weight on long-term

shareholder value than would a proper conception of social welfare. As well, shareholders' insulation from the social and moral pressures that generate prosocial behavior at the individual level mutes their social preferences with respect to corporate conduct. Finally, conflicts among shareholders about social issues further dampen the role of social preferences in shareholder welfare.

Diversified shareholders' portfolio value is even less normatively attractive as a corporate objective. It captures only a small portion of the externalities like pollution that its proponents hope to address. The type of externalities it does capture effectively are competitive effects on other firms—like competitors' loss of business following a cut to the price of the firm's output—the result of which is to motivate socially destructive anticompetitive conduct.

We then consider the feasibility of implementing each approach. While ESV is substantially feasible in terms of its information demands, management's incentives are more mixed due to standard agency problems. Corporate short-termism is one type of agency cost that might result in management failing to engage in CSR that would benefit shareholders in the long-term. Overinvestment due to empire building in high-negative externality industries is another. In sum, in practice management will sometimes, perhaps often, fall short of the degree of social responsibility that is consistent with the shareholder value objective.

Adding shareholders' social preferences to the corporate objective, however, would provide little by way of incremental incentives to act responsibly. For one, given that shareholders' social preferences are in important part associative, the shareholders actually willing to hold the shares of the companies that pose the greatest social concerns will be those least concerned about the social issues implicated. As well, management faces significant information problems in gleaning the strength and content of the social preferences of their shareholder base. Indeed, diversified shareholders themselves, we submit, would struggle to formulate such preferences across the myriad social issues implicated by their portfolios. These information problems of the SSP approach in turn produce a fundamental incentive problem. With one far more important component of the objective for which managers have reasonably good information—shareholder value—and one far less important component for which they have little information—shareholders' social preferences—the optimal incentive scheme focuses management squarely on shareholder value. Attempts to push management to attend to shareholders' social preferences thus risk doing more harm to shareholder (and social) welfare than good by distracting management from their core competencies.

The story is much the same for PVM. Corporate managers are likely to be far better informed about how their business produces cash flows for the company and about competitive effects on other firms than about other externalities of the company's business on other companies. Nor are institutional investors likely to be in a meaningfully better position to provide information on portfolio externalities to managers. The optimal incentive scheme for firm managers under PVM would thus also focus on long-term shareholder value of the firm. To the extent it would incorporate externalities, they would be largely of the competitive variety, leading to worse corporate behavior from a social perspective.

To be sure, one might seek to sidestep these managerial incentive and information problems by simply devolving greater corporate control to shareholders, and a number of prominent scholars have indeed advocated taking such a direct approach to implementing shareholder welfarism.[10] However, for publicly traded corporations at the center of these proposals, the basic economic logic of centralized management would continue to apply, suggesting any such departure from centralized management would entail sacrificing many of the efficiencies that have long justified this form of corporate organization. As well, recent work in economics suggesting that shareholders would act like social planners were they to have greater voting rights on operational decisions is based on strong assumptions and is in practice implausible. Devolving corporate control to shareholders would therefore offer little benefit in terms of more responsible corporate conduct and would entail substantial costs.

Shareholder governance does hold significant promise for improving corporate conduct, but this promise does not stem from any innovation in our basic understanding of shareholders' interests along the lines of shareholder welfarism. Rather, the future of CSR, as with its past, is with ESV. The existing law-and-economics literature on ESV, however, has been stunted by two key misconceptions, which we attempt to dispel in Part V. The first is to frame ESV as an alternative to shareholder value as a corporate objective. This is a category mistake: ESV is best understood as a reform agenda targeting a particular class of agency costs that harm not only shareholders but also other corporate stakeholders. A second misconception is that the behavior of all the key actors in the corporate system is fully determined by their incentives and so ideas inspired by ESV cannot improve it. But we show that this determinacy paradox is a challenge for all normative arguments in corporate law scholarship. The generality of this analytic challenge for normative arguments in the field has not previously been recognized. Yet we

10. *See infra* Section IV.C.

also provide good reasons to think that this challenge can be surmounted in the case of ESV. We conclude by outlining a research agenda on ESV that would help illuminate the scope for further improvements to CSR through shareholder governance.

I. THE TRADITIONAL DEBATE ABOUT CORPORATE OBJECTIVE

The traditional debate about the objective of a business corporation traces back to an influential exchange almost a century ago between Columbia Law School Professor Adolf A. Berle and Harvard Law School Professor E. Merrick Dodd that grappled with a fundamental question posed by the publicly traded corporation: Given the practical inability of dispersed shareholders to monitor managers, what maximand should managers pursue in exercising their resulting wide discretion over corporate affairs?[11]

A. SHAREHOLDER WEALTH MAXIMIZATION

Berle's solution was to turn to the law of trusts and argue that managers are trustees obligated to exercise their discretion solely for the benefit of the shareholders,[12] which he understood narrowly in terms of their interests in the corporation's profits.[13] It was this view of the corporation that was later reprised in Milton Friedman's famous assertion that corporate executives' "responsibility is to conduct the business in accordance with [shareholders'] desires, which generally will be to make as much money as possible while conforming to the basic rules of the society."[14] For Berle, this was a matter of managerial accountability. The only alternative he saw to the shareholder wealth maximization norm was to simply hand over "the economic power now mobilized and massed under the corporate form . . . to the present administrators with a pious wish that something nice will come out of it all."[15]

11. *See* Dodd, *supra* note 5, at 1147 ("Directors and managers of modern large corporations . . . are free from any substantial supervision by stockholders by reason of the difficulty which the modern stockholder has in discovering what is going on and taking effective measures even if he has discovered it.").

12. *See* A.A. Berle, Jr., *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049, 1049 (1931).

13. Berle, *supra* note 5, at 1367 ("Now I submit that you can not abandon emphasis on 'the view that business corporations exist for the sole purpose of making profits for their stockholders' until such time as you are prepared to offer a clear and reasonably enforceable scheme of responsibilities to someone else.").

14. Milton Friedman, *A Friedman Doctrine—The Social Responsibility of Business Is To Increase Its Profits*, N.Y. TIMES (Sept. 13, 1970), https://www.nytimes.com/1970/09/13/archives/a-friedman-doctrine-the-social-responsibility-of-business-is-to.html [https://perma.cc/NSE6-ZBZU].

15. Berle, *supra* note 5, at 1368.

The shareholder wealth maximization norm has historically enjoyed broad support for several reasons. First, as a matter of economic theory, if markets are complete, firms are price takers, and there are no externalities not effectively addressed by government policy, corporate profit maximization results in a socially efficient outcome in the sense that there is no way to improve anyone's well-being without making someone else worse off.[16] By running the firm to maximize the value of the residual claims, the social pie is also maximized so long as government policy addresses externalities. Under the traditional shareholder value maximization view, then, externalities and distributive concerns are appropriately addressed by government policy, not by corporate managers assuming responsibility for them. Similarly, under these conditions, shareholders with conflicting preferences about the timing of consumption will nevertheless be unified in a corporate mandate to maximize shareholder wealth, since shareholders can satisfy their diverse consumption preferences by borrowing and saving.[17] Second, these theoretical arguments are complemented by the agency cost concerns articulated by Berle. Share value provides a simple metric by which to evaluate managers and to hold them accountable for the efficient deployment of corporate assets. Indeed, pioneering work on agency cost theory by Michael Jensen and William Meckling in the 1970s later formalized Berle's central premise.[18] Lastly, the basic structure of corporate law reflects the shareholder value maximization norm, particularly in the key state of Delaware. While legal authority to manage the corporation is lodged in its board of directors, it is the stockholders who are entitled to elect directors.[19] Likewise, courts have defined the fiduciary duties that directors owe to the corporation as ultimately oriented toward stockholder wealth.[20] A broad range of complementary institutions has developed that further entrench shareholder interests as the primary end of the corporate system.[21]

16. *See* Kenneth J. Arrow & Gerard Debreu, *Existence of an Equilibrium for a Competitive Economy*, 22 ECONOMETRICA 265, 265 (1954).

17. *See generally* Steinar Ekern & Robert Wilson, *On the Theory of the Firm in an Economy with Incomplete Markets*, 5 BELL J. ECON. & MGMT. SCI. 171 (1974)(explaining that with complete markets for borrowing and saving, it is in the interest of each shareholder to maximize firm value).

18. *See* Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 312 (1976).

19. *See, e.g.*, DEL. CODE ANN. tit. 8, § 141(a) (2023); MODEL BUS. CORP. ACT § 8.01(b) (2023) (establishing that business and affairs of corporations shall be managed by or under direction of board of directors); DEL. CODE ANN. tit. 8, § 211(b) (2023) ("[A]n annual meeting of stockholders shall be held for the election of directors on a date and at a time designated by or in the manner provided in the bylaws.").

20. As summarized by Vice Chancellor Laster in *In re Trados, Inc.*, "the standard of conduct for directors requires that they strive in good faith and on an informed basis to maximize the value of the corporation for the benefit of its residual claimants [that is, common stockholders] . . . not for the benefit of its contractual claimants." *In re* Trados, Inc., 73 A.3d 17, 40–41 (Del. Ch. 2013).

21. Dorothy S. Lund & Elizabeth Pollman, *The Corporate Governance Machine*, 121 COLUM. L.

B. STAKEHOLDERISM

In contrast to Berle, Dodd identified a trend in public opinion toward viewing the publicly held corporation as an "economic institution which has a social service as well as a profit-making function"[22] and believing that "business has responsibilities to the community."[23] He viewed this trend in public opinion as desirable and likely to become the view of corporate managers, who would develop business ethics that would be "in some degree those of a profession rather than of a trade."[24] Normatively he argued against the position of Berle that corporate fiduciaries have a legal responsibility just to stockholders in order to preserve the freedom of action necessary for management to fulfill their inchoate social obligations.[25] The conceptualization of those to whom corporate managers owe these social responsibilities as stakeholders took off much later with an influential book aimed at corporate managers by Edward Freeman titled *Strategic Management: A Stakeholder Approach*.[26] Freeman offered a capacious definition of stakeholders as "any group or individual who can affect or is affected by the achievement of the organization's objectives."[27] Owing in part to the influence of Freeman,[28] the school of thought originally launched by Dodd has since become known as "stakeholder theory" or simply "stakeholderism."[29] Under this view, corporate fiduciaries should voluntarily advance not just the interests of shareholders but also the interests of workers, creditors, other suppliers, customers, and all others who are affected by the corporation's activities. The term "corporate social responsibility" is generally used to refer to this view of a firm's obligations to advance the interests of its stakeholders.

To organize the various types of social concerns that animate stakeholder theory, it is useful to distinguish between corporate stakeholders that transact with the firm—which we will refer to as firm patrons—and stakeholders that do not. One type of concern regarding the treatment of firm patrons stems from market failures that lead to inefficient outcomes. A primary source of such market failures is market power. A firm with market

REV. 2563, 2575–78 (2021).

22. Dodd, *supra* note 5, at 1148.

23. *Id.* at 1153.

24. *Id.* at 1161.

25. *Id.*

26. R. EDWARD FREEMAN, STRATEGIC MANAGEMENT: A STAKEHOLDER APPROACH (1984).

27. *Id.* at 46.

28. Joshua D. Margolis & James P. Walsh, *Misery Loves Companies: Rethinking Social Initiatives by Business*, 48 ADMIN. SCI. Q. 268, 279 (2003) ("Freeman's ideas provided a language and framework for examining how a firm relates to 'any group or individual who can affect or is affected by the achievement of the organization's objective.' ").

29. Bebchuk & Tallarita, *supra* note 2, at 94.

power in the labor market, for example, will depress workers' wages in order to maximize its profits.[30] Similarly, market power with respect to its customers can lead to inefficiently high prices for the firm's output.[31] In both cases these deviations from competitive prices result in deadweight costs—inefficient reductions in transactions in the market. Market power also raises distributive concerns—a greater share of the social surplus generated in the relevant market goes to the firm rather than firm patrons. Distributive concerns can also arise even in the absence of market power when the relevant market is competitive and efficient. Stakeholderists might view the low wages in a competitive labor market, for example, as socially undesirable and advocate for the firm to pay its workers more.[32]

Concerns about non-firm patrons, in contrast, typically involve externalities. Consider, for example, climate change. Firms' operations inevitably entail some amount of greenhouse gas emissions, which contribute to the total stock of greenhouse gases in the atmosphere and in turn to the warming of the planet. The global scope of the climate change problem, in terms of both its causes and effects, means that essentially the entire global community is affected by every firm's operations and hence can be considered a stakeholder of every firm. But many other externalities are much smaller in scale, resulting in a firm's local community typically having a greater interest in the firm's operations than those further afield.

Note that the basic normative claim at the heart of stakeholderism—that corporate fiduciaries should voluntarily advance the interests of all firm stakeholders and not just the interests of shareholders—presumes some sort of imperfection in current law and policy or in corporations' responses to it. Stakeholderists argue, in effect, that current public policy is not sufficient to protect stakeholder interests, and so corporate managers should go even further on their own.[33]

Notwithstanding the orientation of corporate law toward shareholder wealth maximization, certain core features of corporate law provide the managerial discretion that is necessary to implement stakeholderism.

30. Efraim Benmelech, Nittai K. Bergman & Hyunseob Kim, *Strong Employers and Weak Employees: How Does Employer Concentration Affect Wages?*, 57 J. HUM. RES. S200, S201 (2022).

31. ROBERT S. PINDYCK & DANIEL L. RUBINFELD, MICROECONOMICS 359 (6th ed. 2005).

32. *See, e.g.*, Addie Stone, *Improving Labor Relations Through Corporate Social Responsibility – Lessons from Germany and France*, 46 CAL. W. INT'L L.J. 147, 150–51 (2016) ("Employees are key stakeholders, and their compensation is an important CSR issue. . . . [C]ompanies should focus their CSR efforts on providing a living wage to its employees.").

33. *See* David L. Engel, *An Approach to Corporate Social Responsibility*, 32 STAN. L. REV. 1, 36 (1979) ("One cannot persuasively claim to have found an extra-profit goal that society wants corporations to pursue, unless one can offer at least a plausible explanation of why the legislature did not long ago enact liability rules, regulations, or other measures, to implement the goal in question quite independently of any management practice of social responsibility.").

Director decision-making in the absence of financial conflicts of interest remains largely shielded from judicial scrutiny by the business judgment rule. As a result, corporate managers enjoy broad discretion to consider an array of stakeholder interests so long as their decisions can be justified as ostensibly in the interests of the corporation.[34] Moreover, many state legislatures have amended corporate statutes to increase the compatibility of corporate law with stakeholderism. For instance, so-called constituency statutes have been adopted in most states—but not Delaware—that make clear that corporate fiduciaries are not required to consider only shareholder interests to the exclusion of other stakeholders' interests.[35] The main motivation for these reforms was to prevent corporate takeovers on the ground that takeovers and their associated restructurings could be harmful to workers and local communities.[36] Even in Delaware, the case law evolved to endorse the prerogative of corporate directors to take action to fend off a premium acquisition offer that the shareholders are eager to accept in order to pursue directors' long-term vision of what is in the corporation's best interest.[37] More recently, the adoption of public benefit corporation statutes has been similarly grounded in a desire to enable business corporations to pursue stakeholderist objectives.[38] These developments show that there is nothing inevitable about privileging the interests of investors in operating a commercial enterprise. Indeed, a wide variety of enterprises—such as consumer cooperatives, producer cooperatives, and nonprofits—have chosen to privilege a different set of stakeholders.[39]

II. ENLIGHTENED SHAREHOLDER VALUE

Stakeholderism correctly identifies that shareholders' interests in corporate profits can conflict with other interests in society. From a static,

34. *See, e.g.*, Shlensky v. Wrigley, 237 N.E.2d 776, 780 (Ill. App. Ct. 1968) (holding that, absent fraud, illegality, or conflict of interest, the decision of the Chicago Cubs not to hold night games was properly in the hands of the board of directors and the courts would not intervene). The court pointed out that the decision might in principle be justified based on the financial interests of the corporation, for example, because of the possible negative effect on the property value of Wrigley Field that a deterioration in the surrounding neighborhood might cause. *Id.*

35. MARGARET M. BLAIR, OWNERSHIP AND CONTROL: RETHINKING CORPORATE GOVERNANCE FOR THE TWENTY-FIRST CENTURY 218–19 (1995).

36. *See, e.g.*, Eric W. Orts, *Beyond Shareholders: Interpreting Corporate Constituency Statutes*, 61 GEO. WASH. L. REV. 14, 23–24 (1992).

37. *See* Paramount Commc'ns, Inc. v. Time Inc., 571 A.2d 1140, 1142 (Del. 1989) (upholding defensive measures by the Time, Inc. board motivated in part by a desire to preserve the company's editorial integrity).

38. *See* Jill E. Fisch & Steven Davidoff Solomon, *The "Value" of a Public Benefit Corporation*, *in* RESEARCH HANDBOOK ON CORPORATE PURPOSE AND PERSONHOOD 68, 68 (Elizabeth Pollman & Robert B. Thompson eds., 2021).

39. *Cf.* HENRY HANSMANN, THE OWNERSHIP OF ENTERPRISE (1996) (developing an efficiency-based theory for the assignment of ownership rights to different classes of firm patrons).

short run perspective especially, these conflicts can loom large. Squeezing suppliers and customers can increase corporate profits at their expense. Cutting back on greenhouse gas emissions will improve the environment but at a direct cost to the company's bottom line. And so on and so forth—the list of such conflicts is endless. But taking a longer-term perspective on the company and its business may lessen the degree of conflict between stockholders and other firm stakeholders. More generally, for a range of reasons, considered in some detail below, it can be in shareholders' interests for the company to incur costs to improve the well-being of the firm's stakeholders. Or put more colloquially, companies can "do well by doing good." This enlightened shareholder value perspective, while often dismissed by stakeholder theorists as insufficient[40] and by shareholder value theorists as uninteresting[41] or even counterproductive,[42] has gained increasing traction in recent years as a way to respond to the concerns of stakeholderism that is compatible with existing institutions that put shareholder interests first.[43]

Today the idea of ESV is more commonly referred to under the moniker "ESG," which stands for "Environmental, Social, and Governance."[44] While ESG is a notoriously protean term, used for a range of different ideas,[45] its origins are as a term that captures ways that investors can improve their risk-adjusted returns by incorporating environmental, social, and governance considerations into their investment process.[46] A key aspect of the standard rationale for the use of ESG factors to improve investment returns is the idea

40. *See, e.g.*, Dodd, *supra* note 5, at 1156–57; COLIN P. MAYER, PROSPERITY: BETTER BUSINESS MAKES THE GREATER GOOD 6–7 (2018) (" 'Doing well by doing good' is a dangerous concept because it suggests that philanthropy is only valuable where it is profitable, and it converts charity into profit-generating entities . . . .").

41. *See, e.g.*, Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733, 744 (2005); Bebchuk & Tallarita, *supra* note 2, at 110 ("Enlightened shareholder value is thus no different from shareholder value tout court.").

42. Lucian A. Bebchuk, Kobi Kastiel & Roberto Tallarita, *Does Enlightened Shareholder Value Add Value?*, 77 BUS. LAW. 731, 734 (2022).

43. *See, e.g.*, Lund, *supra* note 9, at 97–98 (arguing that concerns about corporate short-termism have led to a shift toward an enlightened shareholder value perspective); Jensen, *supra* note 4, at 9 ("Enlightened value maximization uses much of the structure of stakeholder theory but accepts maximization of the long-run value of the firm as the criterion for making the requisite tradeoffs among its stakeholders . . . . In so doing, it solves the problems arising from the multiple objectives that accompany traditional stakeholder theory by giving managers a clear way to think about and make the tradeoffs among corporate stakeholders."); Michael E. Porter & Mark R. Kramer, *Creating Shared Value*, 89 HARV. BUS. REV., Jan.–Feb. 2011, at 62, 64–65; ALEX EDMANS, GROW THE PIE: HOW GREAT COMPANIES DELIVER BOTH PURPOSE AND PROFIT 55–56 (2020).

44. *See* THE GLOBAL COMPACT, WHO CARES WINS, at 3 (2004).

45. For an illuminating discussion of the origins of and diverse meanings ascribed to ESG, see generally Elizabeth Pollman, *The Making and Meaning of ESG*, HARV. BUS. L. REV. (forthcoming), https://papers.ssrn.com/abstract=4219857 [https://perma.cc/3JCD-LP55].

46. *See id.* at 11–13; THE GLOBAL COMPACT, *supra* note 44, at i–ii (2004); Alex Edmans, *The End of ESG*, 52 FIN. MGMT. 3 (2022).

that such factors affect profitability at the level of the portfolio company.[47] Indeed, the notion that paying attention to ESG matters for firm financial performance has become part of the zeitgeist of recent years, with public companies increasingly discussing their ESG initiatives on quarterly earnings calls,[48] hiring executives to oversee ESG reforms,[49] and tying executive compensation to ESG metrics.[50] Another aspect of this rationale for ESG investing is the claim that the stock market misprices ESG factors.[51] To be sure, the term ESG is also used for practices that sacrifice investor returns in order to achieve benefits for stakeholders.[52] But in the main, much of the standard rhetoric around ESG, and its intellectual origins, reflect what we refer to as ESV.[53] As of 2022, some $8.4 trillion in assets under management in the United States are invested using an ESG approach.[54]

ESV theorists typically describe the corporate objective as *long-term* shareholder value. The modifier long-term serves two purposes. First, it signifies that much of the financial value of the firm's shares stems from cash flows it will produce well into the future. Second, it reflects the possibility that a company's stock price might not fully reflect immediately the future cash flows that an action to sacrifice corporate cash flows today will ultimately produce.[55] But the basic valuation framework underlying ESV is entirely conventional: the firm should be managed to maximize the net present value of the firm's equity, calculated by discounting the cash flows available to equity holders using the appropriate risk-adjusted discount rate

47. THE GLOBAL COMPACT, *supra* note 44, at 9; Robert G. Eccles, Ioannis Ioannou & George Serafeim, *The Impact of Corporate Sustainability on Organizational Processes and Performance*, 60 MGMT. SCI. 2835, 2849, 2851 (2014) (finding high sustainability companies outperform low sustainability companies both in terms of stock market and accounting performance).

48. GOLDMAN SACHS EQUITY RESEARCH, THE CORPORATE COMMOTION – A RISING PRESENCE OF ESG IN EARNINGS CALLS 25 (2020), https://www.goldmansachs.com/insights/pages/gs-sustain-corporate-commotion-f/report.pdf [https://perma.cc/AUE3-3YTN].

49. *See* Stavros Gadinis & Amelia Miazad, *Corporate Law and Social Risk*, 73 VAND. L. REV. 1401, 1420 (2020).

50. THE CONFERENCE BOARD, LINKING EXECUTIVE COMPENSATION TO ESG PERFORMANCE 3 (2022), https://www.conference-board.org/pdfdownload.cfm?masterProductID=41301 [https://perma.cc/Z2M6-7NCV] (reporting that 73% of S&P 500 companies tied executive compensation to some form of ESG performance as of 2021).

51. *See* Max M. Schanzenbach & Robert H. Sitkoff, *Reconciling Fiduciary Duty and Social Conscience: The Law and Economics of ESG Investing by a Trustee*, 72 STAN. L. REV. 381, 437 (2020) ("For an investor to be able to profit by trading on ESG factors, the market must consistently misprice them.").

52. *See id.* at 397–98 (referring to this form of ESG as "collateral benefits ESG").

53. *See, e.g.*, UNITED NATIONS PRINCIPLES FOR RESPONSIBLE INVESTMENT, A BLUEPRINT FOR RESPONSIBLE INVESTMENT 7 (2017), https://www.unpri.org/download?ac=5330 [https://perma.cc/W4L7-9FPP] ("That environmental, social and governance factors each contribute to creating long-term value is a case well-understood by many, but remains new to many others – so it is a case we must continue to make.").

54. US SIF FOUNDATION, 2022 REPORT ON US SUSTAINABLE INVESTING TRENDS 2 (2022).

55. *See* Jensen, *supra* note 4, at 17; EDMANS, *supra* note 43, at 121.

(however long it might take for the markets to catch up and price the company's stock accordingly). In other words, ESV is not an alternative conception of corporate purpose—it retains the exact same corporate objective as standard shareholder value theory.[56] Instead, ESV theory identifies a set of mechanisms through which firm managers can increase long-term shareholder value by behaving in a more socially responsible way.[57]

With respect to the treatment of firm patrons, one mechanism posited entails a type of efficiency wage: treating a class of firm patrons better can induce reciprocal improved treatment of the firm by those firm patrons. For example, when a firm pays its workers better than their outside option—the market wage for similar labor—workers have greater incentive to perform their jobs well, in order to reduce the risk of dismissal, and the resulting increase in productivity can more than compensate for the firm's increased wage bill.[58] Other accounts emphasize the importance of employee morale and perceptions of fairness: workers who are paid what they consider to be an unfair wage are likely to shirk or otherwise cut back on effort and vice versa.[59] Similarly, a corporation that invests in promoting a diverse and inclusive work culture might boost employee motivation and performance[60] and attract talented workers away from less enlightened competitors.[61] Consistent with this view—and with the stock market underpricing the benefits of favorable treatment of workers—the shares of companies identified as among the "100 Best Companies to Work For in America" earned significant excess returns from 1994 to 2009.[62]

56. Analyses of ESV as a distinct normative standard for corporate decision-making thus largely miss the point of ESV. *See generally, e.g.*, Bebchuk et al., *supra* note 42. We discuss critiques of ESV in some detail in Part V *infra*.

57. For instance, a recent *McKinsey Quarterly* publication identifies five distinct channels through which more socially responsible corporate behavior can improve long-term profitability. Witold Henisz, Tim Koller & Robin Nuttall, *Five Ways that ESG Creates Value*, MCKINSEY Q., Nov. 2019, at 4.

58. *See* Carl Shapiro & Joseph E. Stiglitz, *Equilibrium Unemployment as a Worker Discipline Device*, 74 AM. ECON. REV. 433, 433–34 (1984).

59. George A. Akerlof & Janet L. Yellen, *The Fair Wage-Effort Hypothesis and Unemployment*, 105 Q. J. ECON. 255, 263 (1990).

60. *See* DELOITTE, WAITER, IS THAT INCLUSION IN MY SOUP?: A NEW RECIPE TO IMPROVE BUSINESS PERFORMANCE 4 (2013), https://www2.deloitte.com/content/dam/Deloitte/au/Documents/human-capital/deloitte-au-hc-diversity-inclusion-soup-0513.pdf [https://perma.cc/5D8G-PHNA]; Jie Chen, Woon Sau Leung & Kevin P. Evans, *Female Board Representation, Corporate Innovation and Firm Performance*, 48 J. EMPIRICAL FIN. 236, 237 (2018).

61. Gail Robinson & Kathleen Dechant, *Building a Business Case for Diversity*, 11 ACAD. MGMT. EXEC. 21, 25 (1997).

62. Alex Edmans, *Does the Stock Market Fully Value Intangibles? Employee Satisfaction and Equity Prices*, 101 J. FIN. ECON. 621, 621 (2011) [hereinafter Edmans, *Does the Stock Market Fully Value Intangibles?*]; *see* Alex Edmans, *The Link Between Job Satisfaction and Firm Value, with Implications for Corporate Social Responsibility*, 26 ACAD. MGMT. PERSP. 1, 11 (2012) [hereinafter Edmans, *The Link Between Job Satisfaction and Firm Value*].

A related mechanism stems from the value of inducing firm-specific investments from firm patrons. A firm's contracts with its patrons are often long-term and, in important respects, implicit.[63] Workers, for example, invest in human capital that is to some extent specific to the firm and less valuable elsewhere. In order to induce workers to make such costly investments, the firm promises in return to pay them a share of the surplus generated by their increased productivity. For such relational contracts to work, however, firm patrons must be able to trust the firm to perform its end of the bargain down the line. Breaching that implicit contract by cutting wages, say, can ultimately harm shareholders by destroying the firm's reputation for trustworthiness.[64]

The ESV perspective also posits a set of mechanisms through which incurring costs to treat non-patrons well can ultimately create net financial benefits to shareholders. Consider, for example, an energy company's decision of how much to invest in exploring for oil. The optimal level of investment if one takes a myopic view and assumes that the current market demand for oil will continue indefinitely might be much higher than if one instead adopts a more realistic forecast of the coming transition to a low-carbon economy due to future policy changes and technological developments. The idea is that putting one's head in the ground and investing based on a naïve assumption of continuing demand, even if it generates increased profits in the short- to medium-term, risks the eventual incurrence of large losses on stranded assets.

The social preferences of one class of firm patrons can also produce financial incentives to treat other classes of firm patrons and non-patrons well.[65] For instance, given consumer demand for environmentally sustainable products, investment in these products can result in increased profits as well as an improved environment.[66]

63. *See* OLIVER E. WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM: FIRMS, MARKETS, RELATIONAL CONTRACTING 194 (1985).

64. Andrei Shleifer & Lawrence H. Summers, *Breach of Trust in Hostile Takeovers*, *in* CORPORATE TAKEOVERS: CAUSES AND CONSEQUENCES 33, 37–38 (Alan J. Auerbach ed., 1988). Implicit contracts and the value of the firm's reputation can also provide reasons for the firm to act in a socially responsible manner with respect to its customers. Consider a car insurance company that can increase its profits in the short run by engaging in various practices that slow down or limit the payment on policyholders' claims. Such short-term financial benefits, however, might be swamped by the future costs of lost customers from the resulting harm to the firm's reputation as a reliable insurer that treats its policyholders fairly.

65. The social views of Millennial and Gen Z workers and customers might produce greater incentive for firms to engage in more socially responsible behavior than in the past, given their evidently greater willingness to express those views in their decisions about where to work and shop. *See* Michal Barzuza, Quinn Curtis & David H. Webber, *The Millennial Corporation*, 28 STAN. J.L. BUS. & FIN. 255, 259–61 (2023).

66. Stephanie M. Tully & Russell S. Winer, *The Role of the Beneficiary in Willingness to Pay for*

While the foregoing identifies conceptually coherent mechanisms through which incurring costs to further stakeholder interests can ultimately redound to the financial benefit of stockholders, we do not mean to suggest that all corporate decisions ostensibly justified on that basis are in fact in stockholder interests. Indeed, ESV arguments might be advanced strategically by stakeholderists for actions that in fact will reduce long-term shareholder value. Similarly, ESV might be used as cover by management for actions taken to further management's interests at the expense of stockholders.[67] We return to the information and incentive problems posed by ESV in Part IV below.

III. SHAREHOLDER WELFARISM

The ESV view posits considerable alignment between the financial interests of shareholders in the long-term and the interests of other firm patrons and the broader society. It thus provides one avenue to pursue CSR through shareholder governance. We now consider an alternative approach to doing so that is newer to the scene, which we refer to as *shareholder welfarism*. It posits that corporate management should seek to maximize shareholder welfare, not just share value, by incorporating a more complete understanding of how the corporation affects the well-being of shareholders. There are two primary strands of shareholder welfarism in the literature—the shareholder social preferences view and the portfolio value maximization view—which we take up in turn.[68]

Socially Responsible Products: A Meta-Analysis, 90 J. RETAILING 255, 265 (2014).

67. Jonathan Macey, *Why Is the ESG Focus on Private Companies, Not the Government?*, BLOOMBERG L. (Aug. 19, 2021, 1:01 AM), https://news.bloomberglaw.com/esg/why-is-the-esg-focus-on-private-companies-not-the-government [https://perma.cc/C8ZM-4Y3Q] ("Managers like ESG investing because the concept is so complex and multi-faceted that almost any action short of theft or outright destruction of corporate property can be defended on some ESG ground or the other.").

68. A third version of what we call shareholder welfarism focuses on the direct effects of corporate externalities on the well-being of shareholders—for example, shareholders' health may be harmed by corporate pollution. *See* Michael Simkovic, *Natural-Person Shareholder Voting*, 109 CORNELL L. REV. (forthcoming 2024) (manuscript at 4), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4180982# [https://perma.cc/H52C-ZAV3]. We view this as a less significant component of shareholder welfare, in part because the wealth generated through share ownership may enable shareholders to avoid exposure to many corporate externalities. *Id.* Moreover, much of our analysis of SSP and PVM apply to the direct effects component as well, so we omit treatment of this version in the interest of brevity.

A. SHAREHOLDER SOCIAL PREFERENCES

The shareholder social preferences ("SSP") version of shareholder welfarism begins with the commonsense observation that public company shareholders care about more than just their own wealth—they also have ethical and social concerns. Many shareholders care about the environment, inequality, and racial justice, to give just a few examples, based on their own personal normative commitments. There is of course a wide range of views on such social issues. But while public company shareholders might not be perfectly representative of the entire population, there is no reason to think that corporate shareholders, unlike others in society, are narrowly self-interested and lack any social preferences.

Many shareholders would thus presumably often prefer that company management sacrifice share value in order to further their social preferences, at least to some extent. Consumer markets provide a useful analogy. Consider fair trade coffee, which is sold in major grocery chains across the United States. Fair trade goods are marketed to consumers at a premium price on the basis that the greater markup is passed on to poor producers. This is intended to appeal to consumers with ethical concerns about the treatment of such producers. Such a consumer might be willing to pay more for goods that promise better outcomes for the producers, a hypothesis confirmed by experimental evidence.[69] Suppose those same consumers are also shareholders of a corporation that sources coffee beans. The SSP view posits that those same social preferences would also lead them to be willing to sacrifice investment returns as shareholders in order for the corporation to pay producers more.[70] Under the SSP view, corporate fiduciaries should manage the corporation not to maximize shareholder wealth but rather to maximize shareholder welfare, incorporating shareholders' social preferences.[71]

To be sure, in some cases, shareholder welfare so conceived is in fact maximized by simply maximizing shareholder wealth. Corporate charitable contributions provide an example. Tax complications aside, the goal of furthering shareholder social preferences provides no basis for such corporate philanthropy since the corporation could instead pay those funds

69. The leading study found that replacing a generic product label with a Fair Trade label increases sales of coffee by almost 10%, with higher demand holding steady at up to an 8% price premium. Jens Hainmueller, Michael J. Hiscox & Sandra Sequeira, *Consumer Demand for Fair Trade: Evidence from a Multistore Field Experiment*, 97 REV. ECON. & STAT. 242, 253 (2015).

70. There is some evidence, however, that individuals are less willing to pay to advance social concerns in investment decisions than in consumption decisions. *See* Scott Hirst, Kobi Kastiel & Tamar Kricheli-Katz, *How Much Do Investors Care About Social Responsibility?*, 2023 WIS. L. REV. 977, 1011.

71. Oliver Hart & Luigi Zingales, *Companies Should Maximize Shareholder Welfare Not Market Value*, 2 J.L. FIN. & ACCT. 247, 263 (2017).

out to shareholders, who in turn could donate directly to charity. Oliver Hart and Luigi Zingales—prominent proponents of the SSP view—characterize this as a case in which the social concern is "separable" from the company's business.[72] But Hart and Zingales argue convincingly that social concerns and moneymaking by the company are often inseparable.[73] They offer as an example shareholder concerns about mass shootings. Walmart might much more effectively advance those shareholder social preferences by no longer selling high-capacity magazines than by contributing the profits from doing so to charity.[74] Indeed, it seems plausible that for virtually every major CSR concern there are important aspects of the problem that are not completely separable from the businesses of the corporations involved.

The extent to which shareholders are willing to sacrifice their wealth to address various social concerns of course varies from shareholder to shareholder. Hart and Zingales propose that such heterogeneity be handled through voting by shareholders.[75] The board of directors of the corporation could be required to periodically poll shareholders about corporate policies that implicate social concerns so that the median shareholder's views on the issue (on a share-weighted basis) prevail. Implicit in this voting-based approach is that the "shareholder welfare" objective weights each shareholder's preferences by the number of shares they own.[76]

A further wrinkle is that most corporate shares today are held by institutional investors.[77] Under the SSP view, it is the social preferences of the underlying investors in those institutions that corporate management should seek to advance. Institutional investors would thus have to channel their investors' views in voting the stock in their portfolio companies in order for corporate voting to accurately reflect shareholder welfare. Hart and Zingales envision asset managers segmenting the market based on the social views the asset manager will seek to advance in voting shares of its portfolio companies, so that individual investors can simply sort themselves to the appropriate asset manager.[78]

72. *Id.* at 249.
73. *Id.*
74. *Id.*
75. *Id.* at 260–61.
76. It is not entirely clear how companies with multiple classes of stock with different voting rights and cash flow rights should be handled under the SSP view. One natural approach would be to calculate shareholder welfare by weighting each shareholder's preferences by the cash flow rights they hold. This would align most closely with the approach taken under the traditional shareholder value view of the corporate objective.
77. Amil Dasgupta, Vyacheslav Fos & Zacharias Sautner, *Institutional Investors and Corporate Governance*, FOUNDS. & TRENDS FIN. (forthcoming) (manuscript at 4), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3682800 [https://perma.cc/3KG8-MW3Q].
78. Hart & Zingales, *supra* note 71, at 265–66. One might wonder whether SSP and shareholder

B. PORTFOLIO VALUE MAXIMIZATION

The portfolio value maximization ("PVM") strand of shareholder welfarism, in contrast, retains the focus on shareholders' financial interests from the traditional shareholder value approach but considers their financial interests from a portfolio perspective. Most shareholders in public companies are highly diversified and increasingly so with the ongoing shift from active management to passive investment vehicles.[79] From this perspective, the actual interests of a firm's shareholders lie in the value of their diversified portfolios, not just in the value of the firm's shares. Accordingly, corporate fiduciaries should seek to maximize the value of the firm's shareholders' portfolios, not their own firm value.

The main implication of the PVM approach concerns between-firm externalities, meaning ways that the decisions of one firm affect the value of other firms. Such spillover effects come in a variety of forms. One form stems from market competition. When a firm gains market share by cutting prices, competing firms often lose customers. Economists refer to this type of external effect as a "pecuniary externality."[80] A quite different form—referred to as a "technological externality"—occurs when a production or consumption activity imposes costs or benefits on other producers or consumers and does not operate through the price system.[81] For example, suppose a factory releases toxic chemicals that reduce agricultural productivity in the surrounding area. From the traditional shareholder value perspective, corporate managers should manage the corporation to maximize the value of its equity without regard to such spillover effects on the value of other firms or on consumers. But under the PVM view, the company's

wealth maximization might yield similar results with regard to CSR given the valuation effects of shareholders' buying and selling stocks according to their social preferences. For instance, if shareholders divest from a dirty company based on their social preferences, the resulting decrease in the company's stock price might arguably induce wealth-minded managers to turn clean in the name of maximizing shareholder wealth. *See* Robert Heinkel, Alan Kraus & Josef Zechner, *The Effect of Green Investment on Corporate Behavior*, 36 J. FIN. & QUANTITATIVE ANALYSIS 431, 432–33 (2001). Eleonora Broccardo, Hart, and Zingales argue against this result given that any fall in prices among dirty firms is likely to be muted by marginal investors who purchase the newly discounted shares on account of the lower weight these investors place on their social preferences. *See* Eleonora Broccardo, Oliver Hart & Luigi Zingales, *Exit Versus Voice*, 130 J. POL. ECON. 3101, 3117–20 (2022). Empirical evidence also suggests that divestment from dirty companies produces only modest price declines. *See* Jonathan B. Berk & Jules H. van Binsbergen, *The Impact of Impact Investing* 2–3 (L. & Econ. Ctr. at George Mason Univ. Scalia L. Sch., Research Paper No. 22-008, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3909166 [https://perma.cc/VJ9N-5Q56]. We discuss sorting of shareholders into firms according to their social preferences *infra* Section IV.B.2.i.

79. Vladyslav Sushko & Grant Turner, *The Implications of Passive Investing for Securities Markets*, BIS Q. REV., Mar. 2018, at 113, 115.

80. J.-J. Laffont, *Externalities*, *in* ALLOCATION, INFORMATION AND MARKETS 112, 113 (John Eatwell, Murray Milgate & Peter Newman eds., 1989).

81. *Id.* at 112.

shareholders would want firm managers to incorporate such external effects to the extent that they reduce the value of other securities held in shareholders' portfolios.

The social desirability of such PVM behavior by firm managers depends critically on the nature of the externality at issue and the extent to which it is internalized in shareholders' portfolios. In the case of pecuniary externalities, having firm managers take them into account would interfere with market competition. For example, if each firm in an industry were operated to maximize the total value of the industry, that would entail pricing their output above the competitive level, with all of the standard inefficiencies from monopoly pricing that would result. In recent years a burgeoning empirical literature claims that the growth of diversified institutional investors has in fact led to such anticompetitive outcomes in certain industries.[82] The internalization of pecuniary externalities through the PVM approach is thus generally not socially desirable.

But for technological externalities, PVM offers hope that running the firm in the true interests of shareholders—maximizing the value of their diversified portfolios—would result in more socially responsible corporate behavior. For example, the portfolio value maximizing level of pollution emitted by a firm would take into account the portion of the costs of that pollution that fall on other firms in the portfolio.

These basic implications of running a corporation to maximize the value of diversified shareholders' portfolios were worked out theoretically by economists decades ago.[83] They entered the legal literature when the growth of private and public pension funds, and their growing use of indexed investment strategies, led to calls for these so-called universal owners to exercise their shareholder rights in order to advance broader social interests with respect to corporate behavior.[84] More recently, Madison Condon has

82. José Azar, Martin C. Schmalz & Isabel Tecu, *Anticompetitive Effects of Common Ownership*, 73 J. FIN. 1513, 1558–59 (2018). But a number of papers have raised methodological concerns with this finding. *See, e.g.*, Patrick Dennis, Kristopher Gerardi & Carola Schenone, *Common Ownership Does Not Have Anticompetitive Effects in the Airline Industry*, 77 J. FIN. 2765, 2766 (2022); Andrew Koch, Marios Panayides & Shawn Thomas, *Common Ownership and Competition in Product Markets*, 139 J. FIN. ECON. 109, 111 (2021); Katharina Lewellen & Michelle Lowry, *Does Common Ownership Really Increase Firm Coordination?*, 141 J. FIN. ECON. 322, 324 n.7 (2021).

83. *See, e.g.*, Julio J. Rotemberg, *Financial Transaction Costs and Industrial Performance* 1–3 (Mass. Inst. of Tech. Alfred P. Sloan Sch. of Mgmt., Working Paper No. 1554-84, 1984), https://dspace.mit.edu/bitstream/handle/1721.1/47993/financialtransac00rote.pdf [https://perma.cc/4DMX-CTC8]; Roger H. Gordon, *Do Publicly Traded Corporations Act in the Public Interest?* 21–22 (Nat'l Bureau of Econ. Rsch., Working Paper No. 3303, 1990), https://www.nber.org/papers/w3303 [https://perma.cc/KF5Q-VY57]; Robert G. Hansen & John R. Lott, Jr., *Externalities and Corporate Objectives in a World with Diversified Shareholder/Consumers*, 31 J. FIN. & QUANTITATIVE ANALYSIS 43, 44 (1996).

84. *See* JAMES P. HAWLEY & ANDREW T. WILLIAMS, THE RISE OF FIDUCIARY CAPITALISM 1–29

argued that attempts by asset managers to pressure their portfolio companies to combat climate change can be explained by their desire to maximize the value of the diversified portfolios they manage.[85]

The PVM literature has thus largely focused on arguments about how diversified institutional investors should or do exercise their ownership rights in order to change a portfolio company's policies in ways that increase the value of their diversified portfolios even at the cost of the particular company's own value.[86] But as Marcel Kahan and Edward Rock argue, responding to such shareholder pressures without changing the legal norm defining the purpose of a business corporation would conflict with the fiduciary duties of corporate officers and directors, which are based on the traditional shareholder wealth maximization norm.[87] In what follows we thus focus our analysis on a more ambitious version of PVM that includes changing the legal definition of corporate purpose to encompass the internalization of externalities that fall on other firms held in their shareholders' portfolios.[88]

* * *

The main appeal of shareholder welfarism, in both its shareholder social preferences and portfolio value maximization guises, is that it seems to hold the promise of addressing the two key problems with conventional stakeholderism. First, it retains the basic norm that shareholder interests are primary in the management of a corporation. As such, shareholder welfarism might be compatible with the standard norms and incentives governing corporate affairs that put shareholders first, which the recent growth of institutional shareholders has further entrenched. Second, each form of shareholder welfarism provides a conceptual framework through which corporate management could determine, at least in principle, how to trade off among competing stakeholder interests. These two key aspects of the

(2000); Jeffrey N. Gordon, *Systematic Stewardship*, 47 J. CORP. L. 627, 632–33 (2022). *See generally* ROBERT A.G. MONKS & NELL MINOW, WATCHING THE WATCHERS : CORPORATE GOVERNANCE FOR THE 21ST CENTURY (1996).

85. Madison Condon, *Externalities and the Common Owner*, 95 WASH. L. REV. 1, 26–27 (2020).

86. *Id.* at 19–26; Gordon, *supra* note 84, at 658–66.

87. Marcel Kahan & Edward B. Rock, *Systemic Stewardship with Tradeoffs*, 48 J. CORP. L. 497, 500 (2023); *see also* Roberto Tallarita, *The Limits of Portfolio Primacy*, 76 VAND. L. REV. 511, 564–65 (2023).

88. Such an approach to PVM is precisely what motivated a 2022 class action lawsuit against Meta Platforms (formerly Facebook, Inc.), which alleged that the directors of Meta had breached their fiduciary duties by choosing to maximize the value of Meta rather the financial interests of Meta's diversified shareholders. In particular, the complaint alleges that the directors failed to consider that shareholders with diversified portfolios may be subject to net losses in their portfolios due to Meta's pursuit of a business model that maximizes its advertising revenue without regard to the harms this conduct inflicts on public health and, by extension, the value of diversified portfolios. *See* Complaint at 2, 18, 72, McRitchie v. Zuckerberg, No. 2022-0890 (Del. Ch. Oct. 3, 2022).

appeal of shareholder welfarism are shared by the ESV view. It too is compatible with existing norms that privilege shareholder interests and provides a clear objective to guide corporate management in trading off current profits in order to further stakeholder interests: long-term shareholder value.

IV. EVALUATING THE THREE APPROACHES TO CSR THROUGH SHAREHOLDER GOVERNANCE

We now turn to evaluating the three approaches to pursuing corporate social responsibility through shareholder governance—enlightened shareholder value ("ESV"), shareholder social preferences ("SSP"), and portfolio value maximization ("PVM")—based on their potential to induce the management of public companies to incur costs on a voluntary basis in ways that further the interests of other stakeholders in the firm (that is, to engage in CSR). We divide our analysis into three parts. We first evaluate the normative attractiveness of the corporate objective posited by each approach, ignoring the practical challenges to inducing corporate managers to pursue each objective. We focus simply on the extent to which each proposed corporate objective captures various social concerns about corporate behavior. We then turn to the feasibility of each approach in terms of the extent to which managers would have the information and incentives needed to pursue the posited corporate objective, taking as given the centralization of control in corporate managers. Finally, we consider the extent to which implementing shareholder welfarism by simply devolving more control to shareholders might improve corporate conduct.

A. NORMATIVE ATTRACTIVENESS OF EACH CORPORATE OBJECTIVE

To what extent do the corporate objectives of ESV, SSP, and PVM capture CSR concerns? Our analysis in this Section can be thought of as adopting the assumption of no information costs and no agency costs: we imagine a world in which public companies fully maximize the corporate objective function posited under each approach. The corporate objective posited by the ESV view is long-term shareholder value, meaning the net present value of the future cash flows paid on the company's equity, discounted based on the firm's opportunity cost of capital.[89] Note that long-term shareholder value is also a major component of the corporate objectives posited by SSP and PVM. ESV and its long-term shareholder value objective thus form a key benchmark against which to judge SSP and PVM. We begin by qualitatively characterizing the extent to which the long-term shareholder

89. Jensen, *supra* note 4, at 9.

value objective of ESV *fails* to capture CSR concerns so that even in a world in which management was perfectly successful at maximizing long-term shareholder value in an enlightened way, there would remain significant residual social concerns. We then turn to the SSP and PVM objective functions and consider the extent to which the further considerations they incorporate in addition to long-term shareholder value might capture CSR concerns beyond the ESV baseline.

1. Enlightened Shareholder Value

We begin by repeating an observation we made in our discussion of stakeholderism in Part I: corporate behavior is significantly shaped by the constraints and incentives produced by law and public policy, much of which is intended to address market failures and distributional concerns that arise from corporate conduct. This forms an important starting point for thinking about how, in a world in which managers perfectly maximize long-term shareholder value, there might remain social concerns about corporate conduct. Those concerns are, by definition, those not addressed by current law and public policy.

One category of social concerns about corporate conduct that would persist in such a world is with respect to the treatment of firm patrons. First, the outcomes for firm patrons—especially workers—might raise distributive concerns. Competitive labor markets, for example, operating under current tax and transfer policies induce a particular distribution of income and welfare in which low-skilled workers, in particular, earn income that many find unfairly low.[90] As we discussed above, maximizing long-term shareholder value generates some incentive for firms to pay their workers more than they otherwise would based on the value of incentivizing effort or firm-specific investment, but this is true only up to a point. Indeed, for workers for which such incentive contracting concerns do not loom large, the shareholder-value-maximizing wage might be little more than the competitive wage in the relevant labor market. Furthermore, it seems likely that such cases will often involve workers with relatively low levels of human capital whose low incomes raise the greatest distributive concerns from a social perspective. Put simply, efficiency wages and the like are no panacea for the standard concerns about the income inequality produced by market economies.

Another limitation of this class of ESV mechanisms stems from last period concerns. Firms have incentives to perform on implicit contracts in

90. THOMAS PIKETTY, CAPITAL IN THE TWENTY-FIRST CENTURY 304–35 (Arthur Goldhammer, trans., 2014).

order to preserve the going concern value of the firm, which relies on the trustworthiness of the firm as perceived by current and future patrons. Implicit contracting thus depends critically on the firm and its patrons having a long future ahead of them. But as the probability that the firm will cease to operate and be liquidated goes up—due to business setbacks, for example—the incentives produced by the value of the firm's reputation for trustworthiness are attenuated.

Market power of firms raises additional social concerns. While efficiency wage and implicit contracting considerations might moderate to some extent the incentive of shareholder-value-maximizing firms to exploit their market power, in the main, the long-term shareholder value objective is better understood as the key cause of the social problems posed by market power rather than as their solution.

In a similar way, maximizing long-term shareholder value provides no universal cure for other sources of contracting failures between the firm and various classes of firm patrons.[91] A firm that possesses better information than its customers about the safety of its products, for example, might well succumb to the temptation to cut back on safety to save costs, correctly concluding that the reputational and other costs of doing so are outweighed by the short-run savings even when viewed through the lens of long-term shareholder value.

With respect to externalities on non-firm patrons, the limits of ESV are even easier to see. By definition, when production or consumption of a firm's output generates a negative technological externality, running the firm to maximize long-term shareholder value will result in socially excessive levels of the activity (and the reverse is true for positive externalities). The mechanisms discussed in Part II through which ESV can incentivize firms to improve their treatment of non-patrons do not change this powerful implication of economic theory. When externalities exist that are not effectively addressed through taxation or regulation, the private costs and benefits of the activity that drive the maximization of long-term shareholder value diverge from the social costs and benefits of the activity.

In summary, ESV mechanisms under the corporate objective of long-term shareholder value only mitigate and do not resolve social conflicts with respect to corporate conduct. We turn now to SSP and PVM to consider the extent to which the objective function posited by each might go further than ESV in motivating CSR.

91. Indeed, the basic thesis of Henry Hansmann's *The Ownership of Enterprise* is that such contracting failures can result in the efficient assignment of ownership of the firm being to a class of firm patrons other than investors. HANSMANN, *supra* note 39, at 1–2.

2. Shareholder Social Preferences

The corporate objective under the SSP view is based on two key components of shareholders' well-being: (1) the long-term value of the shares and (2) shareholders' social preferences with respect to corporate conduct. The weight each shareholder puts on these two components depends on their own preferences. As well, the specific content of shareholders' social preferences will vary from shareholder to shareholder. To calculate aggregate shareholder welfare, individual shareholders' well-being levels are weighted by their share ownership and summed.

Because of heterogeneity across shareholders in the strength and content of their social preferences, aggregate shareholder welfare for a corporation will depend on who owns the shares of the company. In turn, the decisions of individuals to hold the shares may well depend on the conduct of the corporation and the social preferences of the individuals. For now, we adopt the simplifying assumption that all shareholders are fully diversified, so that there is no variation in the share-weighted social preferences of shareholders of different public companies.[92]

Under these assumptions, how would maximizing shareholder welfare, taking into account the social preferences of shareholders, change corporate conduct relative to maximizing long-term shareholder value? Consider first the weight that aggregate shareholder welfare would put on long-term shareholder value. This is an empirical question based on the share-weighted preferences of corporate shareholders. But we make three points that together point to the conclusion that aggregate shareholder welfare would be largely, perhaps even overwhelmingly, based on long-term shareholder value rather than shareholders' social preferences.

To begin, it is useful to contrast shareholder welfare with overall *social* welfare. Social welfare does include as a component a firm's long-term shareholder value—the well-being of the claimants to that value count, of course, in any appropriate measure of social welfare. But social welfare also includes the well-being of those who are *not* shareholders of the firm. In contrast, shareholder welfare would put weight on non-shareholders' well-being based only on shareholders' social preferences. Unless shareholders were perfectly altruistic in the sense that their preferences put as much weight on others as on themselves, this results in shareholder welfare putting greater relative weight on firm value than does social welfare. This effect alone means that maximizing shareholder welfare will generally not provide an incentive for managers to sacrifice profits to the extent required for the

92. We consider the sorting of shareholders across firms *infra* Section IV.B.2.i.

firm to behave appropriately as a social matter. Consider, for example, a profitable factory that emits such a large amount of pollution that, from a social welfare perspective, it should be shut down. Because shareholder welfare puts much more weight on firm profits than social welfare does, it will often not be in shareholders' interests in such a situation to shut down the plant even including consideration of their social preferences.

Second, the shareholders of a public corporation are insulated from the social and moral pressures that generate other-regarding behavior at the individual level.[93] This is due in part to the complex governance structures that stand between individual shareholders and corporate decision-making that make shareholders anonymous to those who might impose social sanctions for harm done by the corporation as well as due to diversified shareholders' basic lack of information about corporate affairs (ignorance is bliss).[94] Einer Elhauge argues that this insulation will result in shareholders putting much more weight on corporate profits relative to social concerns than would sole proprietors, who are far less insulated.[95] This is even more strongly the case with respect to shareholders who own interests in corporate shares through intermediaries like mutual funds and are therefore "double insulat[ed]."[96] In sum, from a revealed preference perspective, the welfare of diversified shareholders might be understood as stemming overwhelmingly from shareholder value rather than from social preferences.

Finally, what little weight shareholder welfare does put on social concerns as opposed to shareholder value is further muted by conflicts among shareholders about social issues. Hart and Zingales introduce the idea of shareholder welfare in a simple model in which the social concern is about pollution that is a by-product of firm operations and shareholders' preferences vary only in terms of the weight they put on environmental harm from the firm's pollution versus on their own wealth.[97] In this framework, aggregate shareholder welfare will be based on the share-weighted average of the weights individuals put on environmental harm relative to personal wealth.

But corporate activities typically pose trade-offs not just between profits and social concerns but also among competing social concerns. As a result, conflicts among shareholders in their views on social issues effectively further reduce the weight of shareholder preferences in determining what maximizes shareholder welfare. In some cases, these

93. Elhauge, *supra* note 41, at 758–59.
94. *Id.* at 798.
95. *Id.* at 799.
96. *Id.* at 817.
97. Hart & Zingales, *supra* note 71, at 252–53.

conflicts are direct. Consider abortion or affirmative action. Some socially minded investors want less of these things; some want more. In those cases, the competing social preferences of different shareholders cancel out to some extent so that, on net, shareholder social preferences get less weight in determining shareholder welfare.

But even for social issues that nobody is against per se, like clean air or good jobs, there are often indirect conflicts stemming from shareholders' social preferences. Consider a manufacturing firm that causes pollution as a by-product of its production process but also provides jobs in a community with scarce economic opportunities.[98] The choice of scale of the firm's output poses trade-offs between environmental quality and jobs. As a result, a socially minded investor who cares about both might ultimately prefer a level of output little different from the profit-maximizing level of output. In contrast, shareholders who care more about the environment than jobs might prefer a lower level of output, and vice-versa for a shareholder more concerned about jobs. The median shareholder's preferences might then be close to the profit-maximizing level of output. So these indirect conflicts about social issues also, in effect, further mute the role of social preferences in shareholder welfare and increase the role of long-term shareholder value.

Note as well that corporations do not generally face binary decisions—like either protect the environment or preserve jobs—but rather face a continuum of choices, as in the example of a firm's choice of level of output. As a result, having a bare majority of shares held by shareholders who lean in one direction on such trade-offs—toward the environment, say—does not mean that the conflicting preferences of the remaining shareholders do not matter for determining the operational decision that maximizes shareholder welfare. For a firm facing a continuum, or at least a large number, of potential operational decisions, the presence of a significant minority of shareholders who care more about jobs than the environment will pull the shareholder-welfare-maximizing choice in the direction of preserving jobs and away from protecting the environment.[99]

In light of these considerations, the social issues for which incorporating shareholders' social preferences into the corporate objective

98. *See* Alperen A. Gözlügöl, *The Clash of 'E' and 'S' of ESG: Just Transition on the Path to Net Zero and the Implications for Sustainable Corporate Governance and Finance*, 15 J. WORLD ENERGY L. & BUS. 1, 4 (2022) (arguing that the transition to net-zero greenhouse gas emissions will result in certain regions suffering substantial employment losses).

99. We put to the side here more profound complications posed by conflicts among preferences of individuals for aggregating those preferences to a social choice, for example, the possibility that majority voting over choices might fail to yield a stable outcome. *See generally* KENNETH J. ARROW, SOCIAL CHOICE AND INDIVIDUAL VALUES (1951).

might potentially make a meaningful difference, relative to the ESV baseline, in motivating CSR would generally be issues on which there is a broad and strong social consensus. But these are exactly the set of issues for which the residual social concerns left under the ESV approach after fully maximizing long-term shareholder value are likely to be minimal, for two reasons.

First, social issues for which there is a strong social consensus are much more likely to be effectively addressed by law and public policy. Federal and state law, for example, provide powerful controls on corporate conduct to address many social concerns raised by corporate operations, from the safety of motor vehicles, to the health consequences of tobacco consumption, to the emission of particulate matter by industrial activities. Our claim is most certainly not that the political process is perfect or that current public policy fully addresses all social concerns about corporate conduct. Rather, it is that the specific issues for which there is sufficient social consensus such that the social preferences of shareholders form a meaningful component of shareholder welfare are precisely the issues that are most likely to be effectively addressed by public policy. Indeed, corporate shareholders' preferences put less weight on average on the social concerns raised by corporate conduct than does the overall polity, for reasons given above. It thus seems likely that for many issues for which there is a strong social consensus, public policy will go well beyond what the company's shareholders would prefer in reining in corporate conduct.[100]

Second, the broad social consensus we are supposing would include not just shareholders but also other classes of firm patrons, including its workers, managers, and customers. The social preferences of firm patrons can provide strong shareholder value reasons for the firm to act in ways that are consistent

100. An example of this dynamic can be seen in the Rule 14a-8 campaign by environmentally oriented shareholders such as As You Sow against oil production companies between 2017 and 2019. These shhareholders sought to compel greater corporate disclosure regarding methane gas leaks arising from their oil production operations. *See, e.g.*, *Dominion Energy, Inc.: Request for Report on Methane Leaks*, AS YOU SOW (Jan. 31, 2018), https://www.asyousow.org/resolutions/2018/01/31/dominion-energy-inc-request-for-report-on-methane-leaks [https://perma.cc/XTR2-BU2Q]. Public polls at this time suggested that 74% of respondents "strongly support[ed]" or "somewhat support[ed]" regulations to reduce methane gas leaks, *see* CLIMATE NEXUS, NATIONAL POLL TOPLINES (2021), https://climatenexus.org/wp-content/uploads/2015/09/Climate-Nexus-National-Poll-2021-Methane-Infrastructure-Toplines.pdf [https://perma.cc/5X4H-UE2D], which may explain why the Biden-Harris administration implemented its Methane Emissions Reduction Action Plan in 2022, *see Fact Sheet: Biden Administration Tackles Super-Polluting Methane Emissions* (Jan. 31, 2022), https://www.whitehouse.gov/briefing-room/statements-releases/2022/01/31/fact-sheet-biden-administration-tackles-super-polluting-methane-emissions [https://perma.cc/QFT9-8GCN]. Notably, despite the widespread public support for regulating methane leaks, shareholder support for 14a-8 proposals aimed at enhancing methane leak disclosures, while occasionally reaching 50% support, often drew far less than majority support. *See Shareholders Are Plugging Methane Leaks Themselves*, AS YOU SOW (June 1, 2018), https://www.asyousow.org/blog/2018/6/1/shareholders-are-plugging-methane-leaks-themselves [https://perma.cc/9W2A-26N5].

with those social preferences. Failing to do so risks inviting a backlash from these other classes of firm patrons that might have major financial consequences.[101]

Consider, for example, explicit and open racism in a firm's treatment of its customers. A recent episode involving Starbucks is instructive. In 2018, a Starbucks employee called the police after two Black men entered a Starbucks in Philadelphia and sat down without purchasing anything and, when store employees asked them to leave, declined to do so. The police forcibly removed the men, leading to national headlines, a public apology by the Starbucks CEO, and the hashtag #BoycottStarbucks trending on Twitter.[102] No reference to Starbucks shareholders' social preferences is needed to explain the decision by Starbucks management several days later to close 8,000 stores to conduct racial bias training of employees.[103]

In summary, under the SSP shareholder welfare objective, it is long-term shareholder value that is the key driver of decisions to incur costs to further stakeholder interests, not the social preferences of shareholders, which are conflicted, muted, and often prefer less protection of stakeholder interests than provided by law.[104]

3. Portfolio Value Maximization

The corporate objective under the PVM approach is diversified shareholders' portfolio value. To evaluate its normative desirability, we maintain for now the simplifying assumption that all investors are fully diversified—that is, they hold the market portfolio of all investible risky assets with each asset weighted in proportion to its value. This is in fact a key assumption underlying the standard model of valuation managers are taught in MBA programs, which is based on the Capital Asset Pricing Model ("CAPM").[105] CAPM provides the original intellectual foundations for the

101. Barzuza et al., *supra* note 65, at 265. As BlackRock's CEO Larry Fink put it in his 2022 letter to CEOs, "Employees need to understand and connect with your purpose; and when they do, they can be your staunchest advocates. Customers want to see and hear what you stand for as they increasingly look to do business with companies that share their values." Larry Fink, *Larry Fink's 2022 Letter to CEOs: The Power of Capitalism*, BLACKROCK (2022), https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter [https://perma.cc/C82G-E8DM].

102. Matt Stevens, *Starbucks C.E.O. Apologizes After Arrests of 2 Black Men*, N.Y. TIMES (Apr. 15, 2018), https://www.nytimes.com/2018/04/15/us/starbucks-philadelphia-black-men-arrest.html [https://perma.cc/FGK9-Z5AA].

103. Rachel Abrams, *Starbucks To Close 8,000 U.S. Stores for Racial-Bias Training After Arrests*, N.Y. TIMES (Apr. 17, 2018).

104. In contrast, Broccardo et al. argue that diversified shareholders, in casting votes about corporate issues, will put *more* weight on social concerns than a sole proprietor would since each shareholder bears only a fraction of the costs of the firm behaving more responsibility. *See* Broccardo et al., *supra* note 78, at 3103. We discuss Broccardo et al.'s model in more detail *infra* Section IV.C.

105. *See, e.g.*, RICHARD A. BREALEY, STEWART C. MYERS & FRANKLIN ALLEN, PRINCIPLES OF

specific model of financial management by which managers are supposed to pursue long-term shareholder value. We begin by sketching how that model works in order to frame more precisely how the PVM approach proposes managers should deviate from it.

In the standard model of corporate decision-making, diversified shareholders want managers to follow the "NPV Rule": invest in every project that has a positive net present value ("NPV").[106] The NPV of a project is calculated by converting ("discounting") all of the future cash flows associated with the project to their present value and then summing those present values as follows:

$$NPV = C_0 + \frac{C_1}{1+r} + \frac{C_2}{(1+r)^2} + \ldots + \frac{C_T}{(1+r)^T}, \qquad (1)$$

where C_T is the net cash flow received from the project in period T and r is the risk-adjusted discount rate for the project.

The assumption of CAPM—that all investors are optimally diversified—plays a key role in the determination of the appropriate discount rate.[107] To capture the cost to investors of bearing the risk of the project, a "risk premium" is added to the risk-free rate (typically taken to be the return on government obligations) to arrive at the risk-adjusted discount rate. But crucially, CAPM considers the risk of a project from a portfolio perspective. That is, a project's risk is measured not in terms of the degree of uncertainty of the project's cash flows considered in isolation but rather in terms of the increment in *portfolio risk* if the project were added to a diversified portfolio. This matters because one component of a project's risks—the idiosyncratic component—disappears when the project is held in a diversified portfolio. A diversified investor only has to be compensated for bearing the risks that they actually have to bear, which is the undiversifiable, systematic component of a project's risk. In CAPM, the only source of systematic risk comes from the correlation between a project's cash flows and the overall market return, which is referred to as the project's beta. The standard shareholder value approach thus already adjusts the *denominators* of the fractions in the above expression for NPV based on a portfolio perspective. So the idea that corporate managers should take a portfolio perspective on the interests of shareholders is actually an old one and entirely conventional. It forms a core component of standard shareholder value theory.

CORPORATE FINANCE 185–99 (10th ed. 2011).

106. *See id.* at 101–03.

107. For a textbook treatment of CAPM, see *id.* at 185–203.

The PVM approach, however, pushes this portfolio perspective further. It incorporates into the cash flows of the project not just the cash flows received by the firm but also the increment in cash flows paid on any *other* securities in the market portfolio. This entails adjusting not only the denominators of the terms in the expression for NPV, but also their numerators. The resulting NPV expression under the PVM approach is:

$$NPV^{PVM} = C_0 + E_0 + \frac{C_1 + E_1}{1 + r} + \frac{C_2 + E_2}{(1 + r)^2} + \ldots + \frac{C_T + E_T}{(1 + r)^T}. \qquad (2)$$

The numerators in the PVM-modified expression for NPV include *both* the expected cash flows from the project that will accrue to the instant corporation (the C_T's) as well as the spillover expected cash flows for other securities resulting from externalities (the E_T's), which could be on net either positive or negative in any given period. For most corporate decisions, the bulk of the cash flows at the market portfolio level in fact accrue to the securities issued by the corporation making the decision. The question we grapple with in this Section is the extent to which the consideration of the additional cash flows to other portfolio securities that the PVM approach requires—assuming no agency costs or information problems—will motivate CSR beyond that justified on the basis of maximizing long-term shareholder value under ESV. We reach an even more negative conclusion than the one we reached in evaluating the SSP objective function: the portfolio value objective will not only produce little additional motivation for CSR, but it will also provide new motivations for socially destructive corporate conduct.

First, taking a portfolio perspective on expected cash flows produced by corporate decisions captures only a small portion of the technological externalities of corporate conduct since the bulk of such externalities fall on interests that are not part of the market portfolio. These interests include the health and well-being of consumers as well as the interests of producers that are not owned in the market portfolio.[108]

108. The aggregate portfolio of the stockholders of a public company would include some assets that are not public securities, and in principle the PVM objective function could include the value of those additional assets. However, we assume that for most investors in public companies, their portfolios are dominated by securities issued by publicly listed firms and other publicly available investments, like U.S. Treasury securities. For instance, even for an extremely diversified institutional investor such as CalPERS, well over half of its $462 billion of assets under management consists of global public equity and publicly offered investment securities such as investment grade debt and U.S. Treasury securities. *See* CALPERS, TRUST LEVEL REVIEW 13, 34 (2023), https://www.calpers.ca.gov/docs/board-agendas/202309/invest/item05b-01_a.pdf [https://perma.cc/98NR-PMPF]. As a result, the PVM objective function would largely fail to capture external effects on other kinds of assets.

To be concrete, consider the facts alleged in *Aguinda v. Texaco*, a class action filed on behalf of residents of certain regions of Ecuador and Peru to recover for property damage, personal injuries, and increased risk of disease allegedly caused by Texaco's improper waste disposal practices in its oil extraction operations in Ecuador.[109] The plaintiffs alleged that Texaco engaged in a range of wrongful conduct, including dumping large quantities of toxic by-products of the drilling process into local rivers and landfills.[110] Texaco allegedly did this to save money, netting additional profits of $500 thousand to $1 million per well.[111] The pollution released by Texaco poisoned the local ecosystem, causing environmental harm, economic losses to local fishermen and agriculture, and serious injuries and disease among local residents.[112]

These allegations represent a paradigmatic case of socially harmful corporate behavior that CSR advocates hope to address. The harms suffered by local residents constituted negative technological externalities that were not effectively controlled through regulation or private law remedies.[113] But they also illustrate a key limitation of the PVM approach: hardly any of these externalities would have manifested as reductions in expected cash flows to securities in the market portfolio. To be sure, the kinds of costs at issue in this example—costs to human health, ecosystems, and small-scale producers—might ultimately have second-order effects on companies in the market portfolio as, for example, the resulting shifts in supply and demand in various markets affect prices of companies' inputs and outputs. But those effects on companies are de minimis and, for that matter, could be on net positive if, for example, the resulting fall in production by small-scale producers resulted in a reduction in supply of products sold by larger companies. To a first approximation, the E_T's for this project would be zero, despite the sizable social externalities at issue.[114]

109. Aguinda v. Texaco, Inc., 142 F. Supp. 2d 534, 537 (S.D.N.Y. 2001).

110. Jota v. Texaco, Inc., 157 F.3d 153, 155 (2d Cir. 1998) (consolidated on appeal with *Aguinda v. Texaco*, 945 F. Supp. 625 (S.D.N.Y. 1996)).

111. Class Action Complaint at 19, Ashanga Jota et al. v. Texaco, Inc, No. 94 Civ. 9266 (S.D.N.Y. Dec. 28, 1994).

112. *Id.* at 5–13.

113. The class actions brought seeking damages and equitable relief in U.S. courts were ultimately dismissed on the basis of *forum non conveniens*. Aguinda v. Texaco, Inc., 303 F.3d 470, 473–74, 480 (2d Cir. 2002).

114. A similar evidentiary challenge appears with regard to the *McRitchie v. Zuckerberg* class action. *See* Complaint, *supra* note 88, at 74. The technological externality at the heart of the case relates to the alleged costs of Meta's pursuit of advertising revenue on public health and the rule of law and, by extension, economic growth. Even assuming Meta's operations created these externalities, it is far from clear whether its actions would have adversely affected a diversified investor's portfolio value, absent an express netting of the costs and benefits of Meta's efforts to maximize the value of the company.

This is also true for larger-scale externalities. Consider climate change, which has been aptly described as "the mother of all externalities."[115] Essentially every business project produces some amount of greenhouse gas emissions, the accumulation of which in the atmosphere leads to warming of the planet over time. Climate change is expected to cause a manifold set of impacts on human well-being. The most recent report by the Intergovernmental Panel on Climate Change ("IPCC") provides a useful taxonomy of the ways climate change is expected to affect human systems:

1. Impacts on water scarcity and food production.
    a. Water scarcity.
    b. Agriculture / crop production.
    c. Animal and livestock health and productivity.
    d. Fisheries yields and aquaculture production.
2. Impacts on health and wellbeing.
    a. Infectious diseases.
    b. Heat, malnutrition and other.
    c. Mental health.
    d. Displacement.
3. Impacts on cities, settlements and infrastructure.
    a. Inland flooding and associated damages.
    b. Flood / storm induced damages in coastal areas.
    c. Damages to infrastructure.
    d. Damages to key economic sectors.[116]

While some of these categories, especially those under "[i]mpacts on cities, settlements and infrastructure," would include substantial effects on companies in the market portfolio, this taxonomy reveals that the scope of the harms from climate change is far broader than those effects.

Indeed, the United Nations Environment Programme's Finance Initiative ("UNEP FI") developed a methodology for assessing the impact of climate change on the portfolios of institutional investors that illustrates the relatively small portion of the costs of climate change that affect the value of

115. Richard S. J. Tol, *The Economic Effects of Climate Change*, 23 J. ECON. PERSPS. 29, 29 (2009).

116. IPCC, 2022, CLIMATE CHANGE 2022: IMPACTS, ADAPTATION AND VULNERABILITY: CONTRIBUTION OF WORKING GROUP II TO THE SIXTH ASSESSMENT REPORT OF THE INTERGOVERNMENTAL PANEL ON CLIMATE CHANGE 10 (H.-O. Pörtner, D.C. Roberts, M. Tignor, E.S. Poloczanska, K. Mintenbeck, A. Alegría, M. Craig, S. Langsdorf, S. Löschke, V. Möller, A. Okem & B. Rama, eds., 2022), https://report.ipcc.ch/ar6/wg2/IPCC_AR6_WGII_FullReport.pdf [https://perma.cc/8T33-BXXS].

the market portfolio in May 2019.[117] The physical risks from climate change included in the analysis are limited to asset damage and business interruption from extreme weather events, a fairly small component of the myriad social costs of climate change identified by the IPCC.[118] This reflects how limited a perspective the PVM objective function brings to the social costs of even large-scale externalities like climate change.

A similar issue concerns the geographic distribution of the social costs of climate change. Existing estimates show that the costs of climate change will be disproportionately borne by lower income regions. For instance, Africa and India are estimated to have aggregate climate damages as a percentage of GDP that are nearly 800% and 1,000%, respectively, greater than those estimated for the United States.[119] Yet to the extent investors access the market portfolio by means of investing in public securities and private company debt, the market portfolio of these securities is tilted toward economic activity in North America and Europe. The standard measure of the extent to which a country's economic activity occurs through public companies and private debt is the country's market-cap-to-GDP ratio. In general, the GDP ratio is much higher for developed economies like those in North America and Europe that are relatively less exposed to the costs of climate change than the GDP ratio for the developing economies that face the largest risks.[120]

This geographic mismatch problem also raises difficulties for one of the standard methodologies for estimating the degree to which reductions in carbon emissions would increase diversified investors' portfolio values. For instance, in an influential paper in *Nature Climate Change*, Simon Dietz, Alex Bowen, Charlie Dixon, and Philip Gradwell estimate that, relative to a world without climate risk, investors can expect to lose $2.5 trillion due to

117. UNITED NATIONS ENV'T PROGRAMME FIN. INITIATIVE, CHANGING COURSE: A COMPREHENSIVE INVESTOR GUIDE TO SCENARIO-BASED METHODS FOR CLIMATE RISK ASSESSMENT, IN RESPONSE TO THE TCFD (2019), https://www.unepfi.org/wordpress/wp-content/uploads/2019/05/TCFD-Changing-Course-Oct-19.pdf [https://perma.cc/R5BD-7HFT].

118. *Id.* at 16. Physical risks are what economists would consider the social costs of climate change, including all effects on human society described in the IPCC 2022 report summarized above. Transition risks, on the other hand, refer to business issues raised by the shift from a high-carbon economy to a low-carbon economy induced by technological change and government policy. For example, the risk that an oil company's proven reserves would fall in value due to the imposition of a carbon tax or fall in demand for oil would constitute a transition risk but should not be considered a social cost of climate change in an economic sense. The PVM approach aspires to induce companies to internalize the physical risks posed by greenhouse gas emissions. Tallarita, *supra* note 87, at 517.

119. WILLIAM D. NORDHAUS & JOSEPH BOYER, WARMING THE WORLD: ECONOMIC MODELS OF GLOBAL WARMING 91 (2000).

120. *See* Martin Čihák, Asli Demirgüč-Kunt, Erik Feyen & Ross Levine, *Financial Development in 205 Economies, 1960 to 2010*, J. FIN. PERSPS., July 2013, at 1, 7. The authors include the value of both public equity and debt and private debt in the numerator of this ratio. *Id.*

the impact of climate risk on global financial assets.[121] Madison Condon likewise estimates that if BlackRock could induce Chevron and Exxon to cut industrial emissions such that 1% of industrial emissions were removed each year through 2100, the global reduction in climate damages would have a net present value of $385 billion.[122] Given the size of BlackRock's portfolio, she estimates that BlackRock would therefore avoid damages to its portfolio with a net present value of $9.7 billion, which would be sufficient to offset BlackRock's losses in the equity values of Chevron and Exxon.[123] But to arrive at these estimates, these scholars all utilize William Nordhaus's Dynamic Integrated Climate-Economy ("DICE") model to estimate the impact of climate change on global GDP growth.[124] They then assume that climate change will have a proportional effect on global financial assets given past research showing that aggregate financial returns generally track GDP growth.[125] However, the DICE model integrates the heterogeneous effects of climate change on different countries to produce a single estimate of the effect of climate change on global GDP growth, ignoring the fact that the costs of climate change will not be shared equally across all countries. This methodology therefore overestimates the effect of climate change on the growth rate for the market portfolio, which is tilted toward economic activity in North America and Europe.

As noted by Roberto Tallarita, a related issue with the objective function of PVM is that it discounts future costs and benefits using the opportunity cost of capital.[126] But for costs and benefits that play out over long time scales that span generations, like those of climate change, economists typically apply a discount rate that is much lower than the opportunity cost of capital to account for intergenerational distributional

121. Simon Dietz, Alex Bowen, Charlie Dixon & Philip Gradwell, *'Climate Value at Risk' of Global Financial Assets*, 6 NATURE CLIMATE CHANGE 676, 678 (2016).

122. Condon, *supra* note 85, at 46 n.237.

123. *Id.*

124. *See* Dietz et al., *supra* note 121, at 677; Condon, *supra* note 85, at 46.

125. *See* Dietz et al., *supra* note 121, at 676; Condon, *supra* note 85, at 46 n.237. A further problem with Condon's analysis is that she uses the wrong denominator for the fraction of climate change impacts internalized by BlackRock's portfolio under management. Formally, Condon first estimates the present value of the reduction in climate damages on global GDP and then assumes that the value of the damage reduction to BlackRock is based on BlackRock's share of the global economy based on the ratio of BlackRock's assets under management ($7.43 trillion) to global GDP (roughly $80 trillion). Condon, *supra* note 85, at 2 n.3, 46 n.237. Because global GDP is a measure of income, the relevant denominator for this purpose should be global financial assets or roughly $143.3 trillion according to Dietz et al. Dietz et al., *supra* note 121, at 678. Using the correct denominator, the estimated reductions in damages to Blackrock's portfolio would decline from $9.7 billion to about $5.5 billion, which is less than the $6.5 billion that Condon estimates BlackRock would lose due to declines in the equity values of Chevron and Exxon. Condon, *supra* note 85, at 46.

126. Tallarita, *supra* note 87, at 548–54.

considerations.[127] This results in the PVM approach massively undercounting the costs of climate change, most of which will not accrue for many decades.[128]

To give a rough numerical sense for the magnitude of this issue, note first that the present value of the future costs of climate change, when using social discount rates in the range typically used for climate policy, stems largely from impacts that will occur beyond the year 2200.[129] To simplify, suppose that all of those impacts occurred in 2200, which is 177 years from the year 2023. Suppose that the right social discount rate to use to convert those costs to present value is 2%, a number often used by experts.[130] At that social discount rate, each dollar of future climate change costs should be discounted by the factor $1/1.02^{177}$, which comes out to 0.03. A $1 trillion future climate change cost in 2200 would then be considered worth $30 billion in present value terms. But applying the 12% real discount rate typically used by corporate managers, the PVM approach would use a discount factor of just $1/1.12^{177}$ or 0.000000002. Under the PVM approach, that $1 trillion future social cost of climate change comes out to just $1,943 in present value terms. Or in different terms, the PVM approach would capture only the fraction $(1/1.12^{177})/(1/1.02^{177})$ or 0.00000007 of the present value of the costs of climate change in 2200 (and even less of those beyond). Even if managers used a much lower discount rate of 7% under PVM, this fraction still comes out to just 0.0002. Discounting alone thus results in the PVM objective function internalizing only a trivial fraction of the social costs of climate change.

The UNEP FI report also illustrates another conceptual problem with the PVM approach: the methodology incorporates the positive business opportunities created by climate change for companies in the market portfolio.[131] The transition to a low-carbon economy and adaptation to a warming planet will require investment in technologies and infrastructure in

127. Moritz A. Drupp, Mark C. Freeman, Ben Groom & Frikk Nesje, *Discounting Disentangled*, 10 AM. ECON. J.: ECON. POL'Y 109, 112–13 (2018).

128. Tallarita, *supra* note 87, at 548–54.

129. Nicholas Stern, *The Economics of Climate Change*, 98 AM. ECON. REV. 1, 20 (2008). For example, in Stern's influential *The Economics of Climate Change*, 90% of the present value of the social costs of carbon emissions stem from impacts that occur after 2200. *Id.*

130. Drupp et al., *supra* note 127, at 128 (reporting that the median social discount rate recommended by experts is 2%). In a 2022 analysis of the social costs of carbon, the EPA similarly used 2% as its central discount rate target. *See* ENV'T PROT. AGENCY, SUPPLEMENTAL MATERIAL FOR THE REGULATORY IMPACT ANALYSIS FOR THE SUPPLEMENTAL PROPOSED RULEMAKING, "STANDARDS OF PERFORMANCE FOR NEW, RECONSTRUCTED, AND MODIFIED SOURCES AND EMISSIONS GUIDELINES FOR EXISTING SOURCES: OIL AND NATURAL GAS SECTOR CLIMATE REVIEW" 2 (2022), https://www.epa.gov/system/files/documents/2022-11/epa_scghg_report_draft_0.pdf [https://perma.cc/P7C9-SW55].

131. UNITED NATIONS ENV'T PROGRAMME FIN. INITIATIVE, *supra* note 117, at 44–45.

a range of sectors. To give one example, consider a concrete seawall installed in New York Harbor to address storm surges caused by climate change. The Army Corps of Engineers has proposed the construction of such a barrier at a cost of some $119 billion.[132] If such a seawall were built in order to deal with climate change, it would count as among the negative externalities of climate change—it is a real resource use caused by the warming of the planet. But from a PVM perspective, the construction of a seawall represents an enormous business opportunity. In other words, while the aspiration of the PVM approach is to incorporate such costs as negative adjustments to expected cash flows for business projects that contribute to climate change (that is, negative E_T's in the PVM-adjusted NPV expression above), in fact faithful application of the PVM approach would incorporate them at least in part as positive adjustments since the construction of the seawall will produce profits for companies in the market portfolio (that is, as positive E_t's).

A final problem with the PVM objective function's treatment of technological externalities is with respect to its interaction with public policies designed to address such externalities. Consider, for example, a pollution externality caused as a by-product of a certain production process, and suppose the externality is addressed at the public policy level with a Pigouvian tax set at the marginal social cost of the externality. As a result, the private profit-maximization problem facing firms that emit that form of pollution mirrors the social problem of choosing efficient behavior. But consider what would happen if managers of the polluting firms were instead to set firm policy following the PVM approach. Those managers would consider not only the Pigouvian tax but also the portion of the externality that reduced the value of other firms in the portfolio so that a portion of the externality would be double counted. As a result, they would, at the margin, be over-deterred from producing pollution. In short, the PVM approach, unlike ESV, does not integrate well with public policy approaches to addressing externalities.[133]

In contrast to these failures with respect to technological externalities, the PVM approach is far better suited to capture pecuniary externalities. One reason is that pecuniary externalities largely involve a company's competitors, a significant fraction of which are public companies. Consider

132. Anne Barnard, *The $119 Billion Sea Wall that Could Defend New York . . . or Not*, N.Y. TIMES (Aug. 21, 2021), https://www.nytimes.com/2020/01/17/nyregion/the-119-billion-sea-wall-that-could-defend-new-york-or-not.html [https://perma.cc/PTK7-SE4A].

133. This problem could be mitigated, in principle, by calibrating the level of the Pigouvian tax to be equal to the portion of the externality that falls on interests other than securities in the market portfolio. However, it is not clear how policymakers could determine that amount.

the airline industry, which is dominated by public companies.[134] When Delta Airlines cuts its fares on the D.C.-Boston route and gains market share, it reduces the value of its competitors on that route, which are largely public companies. As we noted above, however, this feature of PVM is really a bug. If companies fully maximized diversified investors' portfolio value, the resulting reduction in competition would harm consumers and workers even as it benefited investors. The PVM objective function thus poses significant harms to firm patrons relative to the ESV baseline.

To summarize, the objective function under PVM is socially perverse. It fails to capture effectively much of the technological externalities produced by corporate activities while at the same time having the potential to produce a form of market power that would be socially destructive to firm patrons. By our lights the PVM objective function is unattractive as a normative matter.

B. FEASIBILITY FOR CORPORATE MANAGERS

We now consider whether managers would have the information and incentives they would need to pursue the stated corporate objective under each approach. We begin by reiterating the insight that both SSP and PVM effectively build on ESV since long-term shareholder value is a primary component of both shareholder welfare and portfolio value. As such, we first evaluate the information and incentive problems that might confound implementing long-term shareholder value as the corporate objective under ESV. Having established these problems as a baseline, we then turn to analyzing SSP and PVM. In this section we take as fixed the centralization of management of the corporate form in the board of directors and hired professional managers. We analyze the extent to which changing the legal and business norm on the objective of a business corporation from the long-term shareholder value objective of ESV to either the SSP or PVM objectives would improve corporate behavior given the resulting incentives and information of corporate managers. We then consider in Section IV.C whether a structural change to corporate control that would give shareholders a greater say in operational decision-making, as some advocates of shareholder welfarism have urged, would be likely to improve corporate behavior.

134. *See* Niraj Chokshi, *Frontier Airlines I.P.O. Signals a Travel Industry Recovery*, N.Y. TIMES (June 15, 2021), https://www.nytimes.com/2021/04/01/business/frontier-airlines-ipo.html [https://perma.cc/W2N3-BCYT] (noting that as of 2021, the ten largest airlines in the U.S. are publicly listed).

1. Enlightened Shareholder Value

i. Information

The informational burden of ESV is considerable. Part of the challenge stems from the inevitable uncertainty with respect to contingencies far out in the future. As we have emphasized, ESV arguments for CSR often have a temporal structure in which the company incurs costs in the near term in order to achieve benefits to stockholders that play out over a long period into the future. Consider, for example, investing in renewable energy, shutting down a dirty factory, or auditing the supply chain for safe labor practices. To what extent would sacrificing corporate profits in those ways today enhance shareholder value over the long-term?

While these questions are no doubt complicated, we view the information gathering and analytic challenges posed by ESV as squarely in the wheelhouse of corporate management. First, the intertemporal structure typical of ESV is not unique but rather is standard fare in business management. Corporate managers face similar intertemporal challenges in many other aspects of business strategy unrelated to CSR. Should the firm expand production? Should it invest more in research and development? Does it have the optimal capital structure? Business schools train managers in analytic techniques—most prominently discounted cash flow analysis—to grapple with such ubiquitous trade-offs and uncertainties entailed by managing a business.

Today, the specific strategic issues raised by CSR under the ESV approach are part of the bread-and-butter of business school curriculums. New York University's Stern School of Business, for example, currently offers no fewer than 33 courses under the "Sustainable Business and Innovation" specialization, including course titles such as "Corporate Branding & Corporate Social Responsibility," "Sustainability for Competitive Advantage," and "Sustainable Capitalism: A Longer Term Finance Perspective."[135] From the course catalogs alone, it is clear that ESV is a major part of the analytic tool kit and worldview imparted to MBA students. Indeed, business school professors are among the most vociferous

135. *Course Index*, NYU STERN SCH. OF BUS., https://www.stern.nyu.edu/programs-admissions/full-time-mba/academics/course-index [https://perma.cc/725J-N7FH]. By comparison, a mere thirteen courses are offered at NYU under the "Real Estate" specialization. *Id.* Not to be outdone, UC Berkeley's Haas School of Business maintains the Institute for Business and Social Impact which oversees three separate centers focused on corporate sustainability and curates the Michaels Graduate Certificate in Sustainable Business. *Institute for Business & Social Impact*, BERKELEY HASS, https://haas.berkeley.edu/responsible-business/curriculum [https://perma.cc/3ZSV-DM5B]. MBA students at Haas can choose from twenty-nine courses focused on corporate sustainability such as "Climate Change and Business Strategy," "Business and Sustainable Supply Chains," and "Strategic and Sustainable Business Solutions." *Id.*

proponents of ESV.[136]

Stock prices provide an additional source of information for a manager trying to understand the long-term value generated by current corporate policies. Stock markets incentivize the production and aggregation of information about corporate value by stock traders. Even if a manager is concerned that stock prices do not fully reflect long-term value, stock prices surely provide some relevant information to management regarding how to maximize long-term value. For example, the fact that Tesla and General Motors trade today with price-to-earnings ratios of 70 and 4, respectively, must say *something* about the future of internal combustion engines.[137]

In summary, while maximizing long-term shareholder value under ESV puts a substantial informational burden on corporate management, there are good reasons to believe that managers are able to assemble and process a great deal of information about how best to further stakeholder interests so as to maximize long-term shareholder value.

ii. Incentives

Although ESV strikes us as substantially feasible from an information perspective, the story is more complicated with respect to managers' incentives. As discussed in Part I, one reason for optimism stems from the structure of corporate law, which is generally designed with the goal of incentivizing management to maximize long-term shareholder value. Furthermore, Delaware courts have *required* corporate boards to put in place information and reporting systems designed to safeguard against risks to the company's stakeholders that might ultimately harm shareholder interests through, for example, sullying the company's reputation.[138]

Executive compensation for senior officers also produces substantial incentives for managers to maximize shareholder value. Much of these incentives stem from the significant equity component of managers' pay packages, which directly links the wealth of managers to the wealth of shareholders. For example, for the median CEO of an S&P 500 firm as of 2011, a 1% increase in the value of the company's shares would produce an increase in the wealth of the CEO of about $500,000 due to their holdings of

136. *See, e.g.*, EDMANS, *supra* note 43, at 55–56.

137. *Tesla Inc.*, GOOGLE FIN., https://www.google.com/finance/quote/TSLA:NASDAQ [https://perma.cc/QLF5-T9J2]; *General Motors Co.*, GOOGLE FIN., https://www.google.com/finance/quote/GM:NYS [https://perma.cc/U7UP-KS5Z].

138. *See, e.g.*, Marchand v. Barnhill, 212 A.3d 805, 809 (Del. 2019)(declining to dismiss a complaint charging a company's board with breaching its fiduciary duties by failing to implement a monitoring system for food safety and observing that the company could only thrive if its customers "were confident that its products were safe to eat").

company stock and stock options.[139]

Yet, while corporate governance is very much oriented toward the long-term shareholder value corporate objective of ESV, by no means does our corporate system produce perfect incentives for corporate management to maximize long-term shareholder value. Perhaps most obviously, standard agency cost theory teaches that whenever managers do not own 100% of the firm's residual claims their incentives are not perfectly aligned with those of shareholders.[140] The literature on such incentive problems is vast, and we will not rehearse it all here. For present purposes we concentrate on the main incentive problems that result in failure to engage in forms of CSR that would benefit shareholders.

Perhaps the primary incentive problem related to ESV is corporate "short-termism," in which management focuses myopically on short-run profitability at the expense of long-term shareholder value.[141] A key premise of the standard short-termism argument is that the firm's stock price does not fully reflect what management knows about the value of the firm, for example, because of information asymmetries between managers and investors.[142] Consider the following stylized example. Suppose that managers had private information that an expenditure of $80 (for example, additional investment in research and development) would increase expected revenues by $100. However, investors—because they lack managers' private information—place only 50% probability on revenues increasing by $100 and 50% probability on revenues remaining the same from this investment.[143] As a result, investors would view the investment as having an NPV of -$30, whereas managers would view the investment as having an NPV of $20. In this fashion, the company's stockholders might undervalue a change in a company's operations that would increase long-term

139. Kevin J. Murphy, *Executive Compensation: Where We Are, and How We Got There*, *in* 2A HANDBOOK OF THE ECONOMICS OF FINANCE 211, 236–37 (George M. Constantinides, Milton Harris & Rene M. Stulz eds., 2013).

140. Jensen & Meckling, *supra* note 18, at 312–13. Concern about this problem, of course, is as old as the business corporation itself. *See* ADAM SMITH, THE WEALTH OF NATIONS 124 (P.F. Collier & Son 1902) (1776) ("The directors of such companies, however, being the managers rather of other people's money than of their own, it cannot well be expected, that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own . . . . Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company."). *See generally* ADOLF A. BERLE JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1932) (analyzing agency problems generated by the separation of ownership from control in public companies).

141. *See, e.g.*, THE GLOBAL COMPACT, *supra* note 44, at 5 ("The use of longer time horizons in investment is an important condition to better capture value creation mechanisms linked to ESG factors.").

142. *See* Jeremy C. Stein, *Takeover Threats and Managerial Myopia*, 96 J. POL. ECON. 61, 62 (1988).

143. This example draws on the formal model presented in Stein's article. *See generally id.*

shareholder value.

For such market myopia to actually affect corporate decision-making, however, some sort of "transmission mechanism" must exist that induces corporate management to focus on increasing the company's short-term stock price rather than long-term shareholder value.[144] One potential such mechanism is the corporate takeover market.[145] In particular, managers might be concerned that if the market undervalues the long-term value of a particular strategy, a corporate raider might exploit the temporary mispricing in the company's stock and acquire the company at a price that does not reflect the long-term value of the company, thus deterring managers from undertaking the strategy. In today's corporate landscape, however, a more common version of this concern involves hedge fund activists who take only a minority stake in a target and then agitate for operational or financial changes that might increase the company's share price even if the changes undermine long-term shareholder value.[146] As with corporate takeovers, even just the threat of such activist interventions might produce managerial myopia more broadly by incentivizing management to pay excessive attention to short-term results for fear of the company becoming a target.[147] Even more directly, modern executive compensation packages generally make managers themselves short-term stockholders, and there is some evidence that vesting equity induces CEOs to cut back on long-term corporate investments[148] and to engage in stock repurchases and corporate acquisitions that impair long-term shareholder returns.[149] Corroborating the hypothesis that short-termism might inhibit both firm performance and CSR investments is evidence that both firm performance and investments in stakeholder relationships increase as a result of reforms that improve executives' long-term incentives.[150] The extent of managerial short-termism

144. Mark J. Roe, *Corporate Short-Termism—In the Boardroom and in the Courtroom*, 68 BUS. LAW. 977, 985 (2013).

145. Stein, *supra* note 142, at 63; Martin Lipton, *Takeover Bids in the Target's Boardroom*, 35 BUS. LAW. 101, 109 (1979).

146. Martijn Cremers, Saura Masconale & Simone M. Sepe, *Activist Hedge Funds and the Corporation*, 94 WASH. U. L. REV. 261, 270–71 (2016).

147. Robert Kuttner, *The Truth About Corporate Raiders*, NEW REPUBLIC, Jan. 20, 1986, at 14, 17; *cf.* Stein, *supra* note 142, at 63 ("In [takeover] cases, managers who boost their stock prices by inflating earnings may be attempting to act in the interests of stockholders by preventing them from being unfairly 'ripped off' by raiders.").

148. Alex Edmans, Vivian W. Fang & Katharina A. Lewellen, *Equity Vesting and Investment*, 30 REV. FIN. STUD. 2229, 2231 (2017).

149. Alex Edmans, Vivian W. Fang & Allen H. Huang, *The Long-Term Consequences of Short-Term Incentives*, 60 J. ACCT. RSCH. 1007 (2022).

150. Caroline Flammer & Pratima Bansal, *Does a Long-Term Orientation Create Value?: Evidence from a Regression Discontinuity*, 38 STRATEGIC MGMT. J. 1827, 1827 (2017).

remains controversial,[151] but it provides a coherent conceptual account for why corporate managers might sometimes fail to engage in CSR that would ultimately increase long-term shareholder value.

Other kinds of agency problems can also inhibit CSR under the ESV approach. For instance, managers might engage in empire building or otherwise overinvest in ways that harm long-term shareholder value. For firms that operate in high-negative-externality industries—fossil fuel production, say—such overinvestment can harm other interests in society as well. Alternatively, disloyal managers might claim to sacrifice short-term profitability to further stakeholder interests in the name of long-term value creation when in fact they are engaged in a form of self-dealing.

To summarize, management pursuit of ESV is neither hopeless nor a sure thing. We can expect corporate managers to be able to gather and analyze a substantial amount of the information needed to engage in CSR under the ESV approach and to have considerable incentives to do so, but their information and incentives will not be perfect.

2. Shareholder Social Preferences

Consider now the extent to which changing the corporate objective from long-term shareholder value under ESV to shareholder welfare under the SSP approach is likely to make corporate conduct more socially responsible. For this reform to achieve its goal of increased corporate social responsibility, corporate managers need both information about their shareholders' social preferences and incentives to act on that information.

i. Sorting of Shareholders

A key premise of the SSP approach is that shareholders have social preferences that make them willing, in aggregate, to sacrifice shareholder value in order for the corporation to act more in line with their values. But as an initial matter, will socially minded investors actually be willing to hold the stock of companies whose operations raise the greatest social concerns? So far, we have maintained the simplifying assumption that all shareholders are perfectly diversified. In practice, however, shareholders' incentives to hold the shares of a particular issuer will in fact depend on their social preferences. This is because shareholders' social preferences are, at least in important part, *associative*. By associative we mean that shareholders prefer not to own shares in (or otherwise be associated with) companies whose

151. For a skeptical view, see generally Mark J. Roe, *Stock Market Short-Termism's Impact*, 167 U. PA. L. REV. 71 (2018). Similarly, for a positive view of hedge fund activism, in terms of long-term shareholder value effects, see Lucian A. Bebchuk, Alon Brav & Wei Jiang, *The Long-Term Effects of Hedge Funds Activism*, 115 COLUM. L. REV. 1085, 1121–35 (2015).

business practices they find morally objectionable. One source of evidence for this stems from the portfolios of ESG mutual funds that are marketed to appeal to such investors, which are tilted towards companies with high ESG scores.[152] In turn, mutual funds marketed as socially responsible are disproportionately held by more prosocial investors.[153] The result of such shareholder sorting is to further reduce the importance of shareholder social preferences in the shareholder welfare objective function for the very corporations for which there is the most at stake in terms of CSR. The shareholders that hold companies that raise the greatest social concerns will be systematically the investors least concerned about those social issues.[154]

Hart and Zingales, in proposing the SSP approach, in contrast adopt a very different assumption about the form of investors' social preferences and how they manifest in behavior. They assume that shareholders care about corporate behavior only at the point they are asked to make some decision about it—like voting on a shareholder proposal—and not before or after such a shareholder decision is made.[155] Under their view, environmentalists would have no qualms about owning shares in a coal-mining company. Their social preferences would manifest only if they were asked to decide on some specific operational matter that would implicate their environmentalist views. If shareholders were asked to vote on whether the company should adopt a more environmentally responsible mining technique, say, that would lower shareholder returns to some extent, environmentalist shareholders might vote yes, depending on the weight they put on their environmentalist views and the extent of the lower shareholder return entailed. But under Hart and Zingales's view they would not hesitate to invest in the first place, even if there were no prospect for them to influence the firm's environmental practices. Hart and Zingales thus propose an invest and engage model of socially responsible investing. But if shareholders' social preferences are

152. Quinn Curtis, Jill Fisch & Adriana Z. Robertson, *Do ESG Mutual Funds Deliver on Their Promises?*, 120 MICH. L. REV. 393, 424 (2021).

153. Arno Riedl & Paul Smeets, *Why Do Investors Hold Socially Responsible Mutual Funds?*, 72 J. FIN. 2505, 2507 (2017). Individuals' direct holdings of stock exhibit a similar phenomenon. In particular, individuals who vote in favor of shareholder proposals pressuring the company to act more responsibly are more likely to hold renewable energy firms and less likely to hold fossil-fuel producers. Jonathon Zytnick, *Do Mutual Funds Represent Individual Investors?* 39 (NYU L. & Econ., Research Paper No. 21-04, 2022), https://papers.ssrn.com/abstract=3803690 [https://perma.cc/X2MQ-ZHMD] ("[I]ndividuals who vote in favor of SRI proposals are more likely to own renewable energy firms and less likely to own fossil fuel producers.").

154. *See* Ľuboš Pástor, Robert F. Stambaugh & Lucian A. Taylor, *Sustainable Investing in Equilibrium*, 142 J. FIN. ECON. 550, 553–57 (2021) (developing a model of investing in an economy in which investors differ in their degree of concern about corporate social behavior and showing that, in equilibrium, dirty firms are disproportionately held by investors least concerned about corporate social behavior).

155. Hart & Zingales, *supra* note 71, at 253. They adopt the same approach in their later work on shareholder social preferences. *See* Broccardo et al., *supra* note 78, at 3103.

strongly associative, as existing evidence suggests, then this model would work only for companies with operations that are already relatively socially responsible, substantially undercutting the potential of SSP to improve corporate conduct.[156]

ii. Information

In order for the shift to shareholder welfare as the corporate objective to affect corporate behavior in the intended way, managers must have information about their shareholders' aggregate social preferences. Relevant preference information would include shareholders' willingness to pay, in terms of reduced shareholder returns, to further various social concerns as well as how shareholders view trade-offs among competing social concerns. A natural way to gather such information would be for corporate management to poll their shareholders.[157]

One version of this would be for management to poll shareholders for their views on concrete corporate operational matters that implicate various social concerns. As a preliminary matter, however, note that diversified shareholders generally lack the information and expertise needed to understand the trade-offs available between firm value and social concerns—this is the core economic logic of centralized management. Put simply individual shareholders are unlikely to know what corporate decisions would maximize their utility.

Consider, for example, the shareholders of a social-media company. Many of these shareholders might share a belief that the corporation should protect the privacy and data of its users, but they likely have little knowledge of the different corporate practices that could advance those interests and the trade-offs they would entail. In principle, shareholders could, with the help of management, inform themselves of the relevant options and their associated costs, but doing so would entail costs that would likely deter diversified shareholders from doing so.[158]

156. To be sure, it could be that the current practice of associative avoidance rather than invest and engage is a function of current corporate governance institutions oriented around shareholder value. Although we are skeptical, it is possible that moving to the SSP regime could cause shareholders to change their sorting behavior and adopt an invest and engage model of socially responsible investment. But such a shift would require that the SSP approach make a substantial difference in corporate behavior, and in what follows we provide further reasons to believe that it would not. *See infra* notes 159–175 and accompanying text.

157. *See* Hart & Zingales, *supra* note 71; Alex Edmans & Tom Gosling, *How To Give Shareholders a Say in Corporate Social Responsibility*, WALL ST. J. (Dec. 6, 2020, 11:00 AM ET), https://www.wsj.com/articles/how-to-give-shareholders-a-say-in-corporate-social-responsibility-11607270401 [https://perma.cc/5U8E-4BKW] (arguing in favor of periodic shareholder votes on "corporate purpose" as a way for management to elicit information about shareholders' social preferences); Jill E. Fisch, *Purpose Proposals*, 1 U. CHI. BUS. L. REV. 113, 128–55 (2022) (analyzing purpose proposals).

158. Skepticism regarding whether shareholders are well-positioned to evaluate specific corporate

Consider then instead the possibility that management might learn information just about the content and strength of shareholders' social preferences rather than shareholders' views about specific operational decisions. Even at this raw preference level, however, we are skeptical that shareholders have clear preferences in any meaningful sense about the relevant trade-offs, much less that management could realistically learn much about them. For example, consider again a social-media company. Another major social concern about social media is its role in the spread of disinformation. Suppose you, dear reader, were a shareholder of a social-media company that had been plagued by such problems in the past. How much return would you be willing to sacrifice in order to reduce this problem? If you are like us, you are having trouble even coming up with a coherent metric for expressing such a preference. Are you willing to sacrifice fifty basis points in return for a reduction of one . . . disinformation unit?

Put another way, shareholder voting provides information about the stated preferences of shareholders but not necessarily their revealed preferences. As a result, a risk exists that asking what any given shareholder prefers in terms of social issues and investment returns might result in the shareholder expressing a preference that is inconsistent with the policy the shareholder would adopt if forced to pay directly for the policy adoption.[159] As well, we might question whether preference elicitation is in the wheelhouse of corporate managers.

These informational challenges facing SSP are not much diminished when we consider intermediation by institutional investors. Hart and Zingales propose that such intermediaries might provide a means of lowering the cognitive load on diversified investors of expressing their social

policies also appears in the SEC's policy of excluding 14a-8 proposals that seek "to 'micro-manage' the company by probing too deeply into matters of a complex nature upon which shareholders, as a group, would not be in a position to make an informed judgment." Amendments to Rules on Shareholder Proposals, Exchange Act Release No. 34-40018, 63 Fed. Reg. 102, at 29109 (May 28, 1998).

159. Economists are traditionally skeptical of using stated preference methods for eliciting individuals' valuations of public goods and the like as a guide for welfare analysis. After surveying the empirical literature documenting biases and inconsistencies in responses to surveys eliciting individuals' valuations of various environmental amenities, Peter Diamond and Jerry Hausman conclude that the problems with such stated preference methods:

> [C]ome from an absence of preferences, not a flaw in survey methodology. That is, we do not think that people generally hold views about individual environmental sites (many of which they have never heard of); or that, within the confines of the time available for survey instruments, people will focus successfully on the identification of preferences, to the exclusion of other bases for answering survey questions. This absence of preferences shows up as inconsistency in responses across surveys and implies that the survey responses are not satisfactory bases for policy.

Peter A. Diamond & Jerry A. Hausman, *Contingent Valuation: Is Some Number Better than No Number?*, 8 J. ECON. PERSPS. 45, 63 (1994).

preferences over corporate conduct.[160] Prosocial investors could simply invest in a prosocial mutual fund that will vote its portfolio company shares in order to advance the investors' social preferences. But this essentially just moves the information problem down one level: How can the fund's manager learn about the social preferences of its investors in order to relay that information to corporate managers?[161]

One possibility, suggested by Hart and Zingales, is that investors can "vote with their feet" by sorting into funds that have a track record of voting that investors find attractive.[162] Indeed, Michal Barzuza, Quinn Curtis, and David Webber argue that index-fund providers have become increasingly vocal about their voting records on ESG issues in order to compete for millennial investors, who they argue place a significant premium on social issues.[163]

But empirical evidence provides little support for the idea that investors sort into mutual funds based on their voting policies. For instance, using a dataset that contains the voting records of both individual investors and the mutual funds in which they invest, Jonathon Zytnick examines whether mutual funds vote on CSR-related matters in the same way that their investors vote on CSR-related matters when these investors cast ballots as shareholders.[164] Overall, he finds little overlap between investor preferences and fund voting, especially within index funds.[165] Zytnick attributes the

160. Hart & Zingales, *supra* note 71.

161. In response to this challenge, one could, of course, require institutional investors to solicit the views of their investors and vote accordingly. *See* Jill E. Fisch & Jeff Schwartz, *Corporate Democracy and the Intermediary Voting Dilemma*, 102 TEX. L. REV. 1, 48 (2023) (proposing "a system by which fund managers ascertain the preferences of their beneficiaries and incorporate those preferences into their voting and engagement practices"). Despite its appeal, such an approach would hardly be a mechanism for implementing SSP for several reasons. First, this form of polling would have to overcome the problem of investor passivity in corporate voting. *See* Alon Brav, Matthew Cain & Jonathon Zytnick, *Retail Shareholder Participation in the Proxy Process: Monitoring, Engagement and Voting*, 144 J. FIN. ECON. 492, 500 (2022) (finding only 11% of retail accounts cast votes at annual shareholder meetings). More importantly, soliciting investors' general preferences on social issues would similarly suffer from its inability to capture investors' revealed preferences on the concrete trade-offs implicated by specific voting proposals. Indeed, even advocates of this approach acknowledge the continuing need for institutional investors to engage in informed intermediation given that whatever preferences are expressed through such polling are likely to be "incomplete, inconsistent, or uninformed." Fisch & Schwartz, *supra*, at 9. As such, there could be no assurance that the votes cast by institutional investors would, in fact, reflect the true preferences of a company's beneficial owners.

162. Hart & Zingales, *supra* note 71, at 265.

163. *See* Michal Barzuza, Quinn Curtis & David H. Webber, *Shareholder Value(s): Index Fund ESG Activism and the New Millennial Corporate Governance*, 93 S. CAL. L. REV. 1243, 1265–68 (2020).

164. Zytnick, *supra* note 153, at 27–36.

165. *Id.* at 29. One exception is with respect to ESG funds, which typically vote in favor of CSR-related initiatives, which is consistent with how their investors cast ballots as individual shareholders. But note that ESG funds typically focus on screening out firms with poor ESG track records, reflecting our

overall lack of sorting to rational inattention: as in political voting, investors rationally choose not to investigate how an intermediary votes due to the small likelihood that their investment will cause the intermediary's votes to be pivotal.[166]

Hart and Zingales argue that the lack of investor sorting is due to current corporate governance rules that limit the scope of shareholder voting on CSR.[167] However, even in the absence of such limitations, we question whether sorting among funds based on how they vote on social issues would provide meaningful information to managers about their shareholders' social preferences. First, as we argued above, we doubt that investors have sufficiently well-formed preferences about corporate conduct such that it is even possible for sorting to convey information to corporate managers about those preferences. Second, it would remain prohibitively costly for shareholders to evaluate the stated policies of asset managers. It is not as simple as environmentally minded shareholders buying a "green" mutual fund. As we have emphasized, shareholders' social preferences are heterogeneous, both in terms of their strength relative to wealth in their utility function and in terms of their content. Individual investors will often differ in how they evaluate the trade-offs entailed when a company implements specific CSR-related policies.

Consider, for example, a fund dedicated to carbon reduction. Across the range of policy interventions a company might take to reduce its carbon footprint, how will investors know which ones a Reduce Carbon Fund will pursue, or how it will evaluate the inevitable trade-offs implicated by each course of action? While some investors may adopt a hell-or-high-water ("hah") approach to carbon reduction, others may condition their support on evidence that the intervention will enhance long-term shareholder value. These problems are further compounded in cases in which a corporate decision involves a trade-off between competing social values and not just between a single social issue and investment returns. Many shareholders, for example, might have concerns about the implications of a given carbon reduction policy proposal on other stakeholders, such as workers or

view that investors' social preferences are to a large extent associational. *Id.* at 29–31.

166. *Id.* at 19.

167. Hart & Zingales, *supra* note 71, at 264. State corporate law, for example, gives the board but not shareholders the legal authority to manage the business and affairs of the corporation. This norm prevents shareholders from restricting the board's substantive decision-making authority by enacting bylaws that direct particular substantive outcomes in terms of CSR. *See* CA, Inc. v. AFSCME Emps. Pension Plan, 953 A.2d 227, 234–35 (Del. 2008). In turn, Rule 14a-8 of the federal proxy rules, which gives shareholders the right to put certain shareholder proposals on management's proxy for the annual shareholder meeting, allows management to exclude proposals that are "not a proper subject for action by shareholders under the laws of the jurisdiction of the company's organization." 17 C.F.R. § 240.14a-8(h)(3)(i) (2022).

communities who may be adversely impacted by it.[168]

A final problem with using shareholder voting and similar mechanisms to convey social preference information to corporate management is that shareholders will express their overall preferences about corporate policy, not just the part concerning shareholder value and their social preferences. For diversified shareholders, those overall preferences would include the portfolio effects that PVM—and not SSP—envisions incorporating into the corporate objective. As a result, attempts to implement the SSP approach, to the extent they are successful in tilting corporate decisions toward what shareholders want, will in practice blur into pursuit of the PVM objective including the anticompetitive aspects of it that are socially destructive.

iii. Incentives

As we argued above, shareholder value is a much more important component of shareholder welfare than shareholder social preferences, given heterogeneity and conflicts among shareholders regarding the relevant welfare trade-offs and sorting based on associative preferences. Our analysis also revealed that management has much better information about long-term shareholder value than it has about shareholders' social preferences. In such a setting—with one far more important component of the objective function for which information is readily available and one far less important component for which information is not available—the best scheme for incentivizing corporate management to pursue shareholder welfare under the SSP approach focuses management attention squarely on the important and measurable component, long-term shareholder value, and thus is essentially identical to the ESV approach.

Our argument builds on insights from "multitask principal-agent problems" from contract theory.[169] These models entail a principal who hires

168. Indeed, BlackRock, which is the largest asset manager in the United States, announced a new program in January 2022 called "Voting Choice" whereby it will allow its clients to choose how to vote the portfolio securities of certain BlackRock funds managed on their behalf. SHAREHOLDER RIGHTS DIRECTIVE II — ENGAGEMENT POLICY, BLACKROCK (2022), https://www.blackrock.com/corporate/literature/publication/blk-shareholder-rights-directiveii-engagement-policy-2022.pdf [https://perma.cc/Y3N5-8JN3]. While the initial program includes only institutional clients, the firm has announced that it is "committed to a future where every investor—even individual investors—can have the option to participate in the proxy voting process if they choose." Fink, *supra* note 101. On the one hand, these changes might be thought of as facilitating the SSP approach by enabling shareholders who invest through intermediaries to express their views on social issues. But we suspect that this emerging devolution of voting responsibility to beneficial owners reflects both the difficulties asset managers face in determining their investors' preferences and the intractability of the conflicts among shareholders in their social preferences. These changes enable asset managers to sidestep these issues and push down the costs of becoming informed on the issues being voted on to their underlying investors, who lack incentives to bear them, ultimately undermining the feasibility of the SSP approach.

169. Bengt Holmstrom & Paul Milgrom, *Multitask Principal–Agent Analyses: Incentive Contracts, Asset Ownership, and Job Design*, 7 J.L. ECON. & ORG. 24, 25 (1991).

an agent to perform several tasks or, similarly, a single task with multiple dimensions to it. A common problem in such an environment arises when performance on one dimension of the job is easily measurable while performance on another dimension is difficult to measure. Teacher performance is a classic example. Standardized tests can measure one dimension of teacher performance, but other aspects—promoting creativity or communication skills—are much harder to measure. In such a setting, the agent decides how to allocate effort across the dimensions of the job, and an increase in incentives on the more easily measurable dimension of their performance will result in the agent reallocating their effort toward that dimension and away from the others.

In a pathbreaking article working through the implications of such a setting for contract design, Bengt Holmstrom and Paul Milgrom argued that the optimal contract might entail very low-powered incentives, like a fixed wage, in order to avoid distorting the agent's effort too much in the direction of the more easily measurable dimension of the job.[170] In the application to teachers, the idea is that paying teachers based on a fixed salary would result in better overall teacher performance than paying them based on the performance of their students on standardized tests since the more balanced allocation of teacher effort across the different dimensions of their job that would result—based on teachers' intrinsic motivations—is more important than the fall in overall effort from giving up on high-powered extrinsic incentives on the measurable aspect of their performance.

In our setting, a low-powered incentive contract in the spirit of Holmstrom and Milgrom's analysis would entail giving up on providing managers high-powered incentives to maximize shareholder value in order to induce them to put some effort into measuring and furthering shareholders' social preferences. For example, managers could be paid like bureaucrats, with fixed salaries and no equity-based component to their pay. But this is not the optimal contract here, for two reasons.

First, as we have explained, long-term shareholder value is a more important component of shareholder welfare than is shareholder social preferences—by far—and, in addition, managers have much better information about how to maximize shareholder value than about how to satisfy shareholders' social preferences. As a result, managerial effort to maximize shareholder value is generally much more productive, in shareholder welfare terms, than is managerial effort to further shareholders' social preferences. Consider, then, how shareholders would ideally want managers to allocate their finite time and attention across those two tasks.

170. *Id.* at 35–38.

For the sake of argument, suppose that management were to focus exclusively on maximizing shareholder value and ignored shareholders' social preferences. From this benchmark, would shareholders' welfare increase if management were to divert some of its attention to figuring out how best to further shareholders' social preferences? We think not. The resulting fall in shareholder value would matter more to shareholder welfare than whatever small improvement management could achieve in better aligning firm policy with shareholders' social preferences.

Second, suppose we are wrong about that, and in fact shareholders would ideally want management to devote at least some attention to furthering shareholders' social preferences. That alone is not sufficient for the optimal incentive contract for management to be one that avoids high-powered incentives to maximize firm value. The optimal design of incentives depends not only on the relative productivity of management's efforts on the two tasks but also on management's intrinsic motivation to pursue the tasks as well as on the availability of good incentive instruments to motivate managerial effort on each of the tasks.

In the application of the Holmstrom and Milgrom multitask model to the problem of incentivizing teachers, a fixed wage contract results in teachers' effort being driven by their intrinsic motivation to help students learn. In the educational context, it seems plausible that teachers have substantial intrinsic motivation—presumably many teachers enter the profession not because the pay is high (it is not) but rather because they like teaching and care about students. As a result of their intrinsic motivations, the fixed wage contract for teachers results in substantial effort across both the measurable and nonmeasurable dimensions of their performance.

But in the corporate context, we think intrinsic motivations play a much smaller role relative to extrinsic motivations. As a result, giving up on extrinsic incentives would result in a substantial fall in managerial effort on maximizing firm value, and for little benefit; it is hard to see why corporate managers would have much intrinsic motivation to figure out shareholders' social preferences and seek to further them.

In terms of the availability of incentive instruments, the key issue is whether there are good proxies for the agent's performance to base their compensation on. When an agent is paid on the basis of some performance measure, they will have incentives to increase the performance measure, which might not produce the desired results. The basic analytic point here is captured evocatively in the title of a classic article in the management

literature: *On the Folly of Rewarding A, While Hoping for B*.[171] In the teacher context, there might not be great proxies even for the relatively measurable aspects of the job. Consider the practice of paying teachers based on their students' test scores. The hope is that doing so will motivate teachers to teach better. But following the introduction of incentive pay based on test scores for teachers in Atlanta, ten teachers and administrators were caught helping students cheat on the test to inflate their scores.[172] Put simply: you get what you pay for.

The implication for the optimal design of incentives is that the fall in effort on the measurable dimension of performance from switching from a high-powered incentive scheme to low-powered incentives depends on how well the former dimension of performance can in fact be measured.[173] In teaching, test scores are a potentially problematic measure even of the aspects of teacher performance they purport to measure, as the cheating scandal illustrates in extreme form. This measurement problem then reduces the benefit, in terms of student learning, of paying teachers based on the proxy. In contrast, in the corporate context, there are excellent performance measures available for shareholder value. The shareholder value component of shareholder welfare is ultimately revealed over time as the firm's cash flows are realized. Executive compensation plans make use of that fact by employing equity-based pay and explicit bonus schemes tied to accounting measures of earnings to generate incentives to maximize shareholder value. We believe that equity-based pay can provide substantial alignment between management's incentives and shareholder value. Giving up on those incentives would therefore result in a substantial loss in shareholder value.

Finally, we do not believe it is optimal to add explicit incentives for managers to further shareholders' social preferences. The shareholder social preferences component of shareholder welfare is much harder to measure than shareholder value and remains largely hidden. Some crude proxy for shareholders' social preferences, based on surveys of shareholders or the like, would have to be constructed to use as a performance measure in management's compensation scheme. But the measurement challenges here reduce the productivity, from a shareholder welfare perspective, of trying to

171. Steven Kerr, *On the Folly of Rewarding A, While Hoping for B*, 18 ACAD. MGMT. J. 769 (1975).

172. Annie Murphy Paul, *Atlanta Teachers Were Offered Bonuses for High Test Scores. Of Course They Cheated.*, WASH. POST (Apr. 16, 2015, 12:43 PM EDT), https://www.washingtonpost.com/posteverything/wp/2015/04/16/atlanta-teachers-were-offered-bonuses-for-high-test-scores-of-course-they-cheated [https://perma.cc/E5P5-PBEP].

173. *See* George P. Baker, *Incentive Contracts and Performance Measurement*, 100 J. POL. ECON. 598, 599 (1992) ("[T]o the extent that the performance measure does not respond to the agent's actions in the same way that the principal's objective responds to these actions, the firm will reduce the sensitivity of the incentive contract to the performance measure.").

provide extrinsic incentives to management to take into consideration shareholders' social preferences.

In sum, the optimal incentive scheme under the SSP view focuses squarely on shareholder value, so that the SSP approach would do little to improve corporate behavior relative to the ESV baseline. One response might be that there is no downside to changing the corporate objective to shareholder welfare under SSP and possible upside. If we are right, the argument goes, that the optimal incentive scheme would remain unchanged, then boards charged with pursuing shareholder welfare under SSP will ensure that management has incentives to stay focused on shareholder value. But it could be, the argument continues, that for some firms, the information and incentive problems we have identified with seeking to further shareholders' social preferences are less severe. For those firms, changing the corporate objective to shareholder welfare under SSP could result in more socially responsible corporate behavior. But in our view, such a change to the legal and business norm about corporate purpose would inevitably result in substantial efforts by many corporate boards to induce the company's senior managers to incorporate shareholders' social preferences into their decision-making even when doing so in fact lowers shareholder (and social) welfare by distracting management from shareholder value.

3. Portfolio Value Maximization

Evaluating the feasibility of PVM as an alternative corporate objective requires assessing whether corporate managers might have the information and incentives needed to incorporate the effects of the firm's decisions on the value of their shareholders' portfolios into their decision-making process, above and beyond how those decisions affect the long-term value of the corporation. We show here that there are good reasons to think they will not.

i. Information

A first type of information managers would need under PVM is on the composition of the portfolios held by the company's shareholders. A company's shareholders are likely to vary widely in the investment portfolios that they hold. Indeed, the large number of investment products offered as mutual funds reflects the strong demand for a broad range of investment portfolios with varying investment objectives. As of November 2023, Morningstar lists over 1,800 investment funds as providing exposure to "U.S. Equity" and nearly 1,100 investment funds as providing exposure to "International Equity."[174] Moreover, the portfolios of these funds reflect a

174. For the list of U.S. Equity funds, see *U.S. Equity Funds*, MORNINGSTAR, https://www.morningstar.com/us-equity-funds [https://perma.cc/24N7-M6WJ]. For the list of International Equity funds, see

broad range of investment theses, such as funds focused on growth firms, small-capitalization firms, low-volatility firms, dividend-paying firms, or firms operating in particular regions or sectors. Note as well that it is not enough for managers to determine what institutional investors hold the company's shares. Institutional investors serve as intermediaries for the underlying individuals on whose behalf they ultimately hold the company's shares. In turn it is those individual investors' portfolios that form the ultimate aggregate portfolio the company's managers should be trying to maximize.

To keep things simple, however, suppose corporate management assumed that the company's shareholders are fully diversified so that the PVM objective is just the value of the market portfolio. This simplifying assumption stacks the deck in favor of the feasibility of PVM, so if PVM is not reasonably feasible under this assumption, then it certainly is not feasible in the real world.

A second type of information a corporate manager would need to pursue PVM is on the expected cash flows that alternative decisions would generate, not only for the company itself but also for other securities in shareholders' portfolios, which again for now we take to be the market portfolio. These expected cash flows to the company and to other securities in the market portfolio are the C_T's and E_T's, respectively, in the numerators of the terms in the PVM version of the expression for the NPV of a project in equation (2) above.

In general, corporate managers will have much better information about the cash flows to the company (the C_T's) than they will about the portfolio externality cash flows (the E_T's). The cash flows to the company are ultimately directly observable and of course directly implicate the business of the company, on which managers are hired to be experts. Externalities, in contrast, involve other businesses that the firm's managers will have much less information about. The information challenges posed by technological externalities are particularly acute. It is not clear how a firm's managers would be able to divine the extent to which pollution emitted by the company, say, would reduce the value of other public companies, which include a diverse array of sectors and industries.[175] In contrast, pecuniary

International Equity Funds, MORNINGSTAR, https://www.morningstar.com/international-equity-funds [https://perma.cc/TZ5P-XGCT].

175. To be sure, there might be some specific technological externalities for which these information problems are less substantial. Most notably, there are aspects of the climate change policy problem that make it more amenable to institutional investors and managers having the requisite information. A ton of CO2 emitted in the atmosphere results in the same marginal social costs regardless of where or how it is emitted, since each such ton contributes the same global stock of greenhouse gases in the atmosphere that in turn causes climate change. Accordingly, institutional investors could

externalities primarily affect the company's competitors, about which firm managers are likely to have substantial information.

Nor are institutional investors likely to be in a meaningfully better position to provide this information to managers. Acquiring information about the E_T's of a portfolio company would require a level of firm-specific engagement likely to be far more complex than acquiring information only about the C_T's of the company by virtue of the diffuse ways a company's operations can affect firms in the market portfolio. Yet even when it comes to firm-specific engagement on increasing a company's C_T's, both active asset managers and index-fund providers have strong incentives to refrain from active engagement.[176] Rather, both types of institutional investors adopt a stance of "rational reticence"[177] in which they weigh in on a company's operations only after an activist hedge fund—which has incentives to investigate how a company might increase its cash flows due to its concentrated investment position—proposes an intervention. Yet by the same token, the fact that an activist is undiversified also means it has little reason to invest in exploring how to reduce the E_T's of a company. Indeed, to the extent an activist surfaces information on a company's technological externalities, it will most likely relate to how they adversely affect the company's cash flows—a point to which we return in Part V. As a result, managers cannot count on institutional investors to solve the critical information challenge posed by PVM.[178]

collaborate with government and other actors to analyze the portfolio effects of climate change, as the UNEP FI has attempted to do. *See* UNITED NATIONS ENV'T PROGRAMME FIN. INITIATIVE, *supra* note 117, at 38–49. Yet even this setting, in which one can plausibly model the portfolio effects of producing a unit of an externality, ultimately illustrates the limitations of the PVM approach. As we have already noted, the offsetting positive effects of climate change for many publicly traded companies, along with the use of discount rates far above the social discount rate and the geographic mismatch between the market portfolio and the economic costs of climate change, means that the net physical costs of climate change on the market portfolio are likely to be de minimis. *See supra* notes 116–133 and accompanying text.

176. For active managers, any action that increases the value of a portfolio company will be shared by all active managers holding a position in the company; therefore, the initiating manager will suffer a decline in relative performance to the other managers who will similarly benefit from the increase in the company's value without having to incur the costs of engagement. *See* Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 COLUM. L. REV. 863, 891–92 (2013). Likewise, index providers compete for assets under management on the basis of their low fees, making the costs associated with such firm-specific engagement incompatible with their business model. *See id.*

177. *Id.* at 867, 889.

178. Due to this challenge, Jeffrey Gordon suggests that, in the context of financial stability risk, institutional investors "ought to devote more firm-specific (and sector-specific) attention to financial firms precisely because (i) they cannot rely on some of the standard intermediaries and (ii) a single-firm failure can present a systemic threat." Gordon, *supra* note 84, at 660. However, even assuming systemic risk of this sort was confined to preventing the failure of, say, any of the thirty firms listed by the Financial Stability Board as a Global Systemically Important Bank, *see* FIN. STABILITY BD., 2022 LIST OF GLOBAL SYSTEMICALLY IMPORTANT BANKS (G-SIBS) 3 (2022), https://www.fsb.org/2022/11/2022-list-of-

ii. Incentives

Consider now the implications of the foregoing analysis for the incentives that firm managers have to pursue the PVM objective. The long-term value of the firm's own shares and the pecuniary portfolio externalities produced by the firm are far more important components of the PVM objective function than the technological portfolio externalities produced by the firm. One reason for this is that there exist social institutions, such as environmental regulation, designed to internalize technological externalities of corporate activity. While these institutions are certainly imperfect, they do substantially limit technological externalities. Another reason is that only a fraction of corporate technological externalities actually falls on other companies' securities, as we explained above. As a result, when managers are considering investing in a new project, typically the primary effect it has on investors' portfolios is through its implications for the company's own value. As well, pecuniary externalities are likely to be far more important to its shareholders than technological externalities for the reasons discussed above. Note that the ordering of these three components of the PVM objective function in terms of their importance to investors mirrors their ordering in terms of the information available to managers.

Incentivizing firm managers to incorporate technological externalities into their decision-making under the PVM approach thus poses a similar problem to that of incentivizing them to consider shareholder social preferences under the SSP approach. The most productive use of managers' scarce time and attention, in terms of improving the PVM objective function, is in working to increase the cash flows to the firm's own shares and to competing public companies. As a result, we think it likely that diversified shareholders would want managers to focus their limited time and attention on those outcomes. Diverting their attention to addressing technological

global-systemically-important-banks-g-sibs [https://perma.cc/UF8J-7Q9T], we question whether active managers and indexers would view active engagement across even these thirty firms as cost justified, given their strong incentives for governance passivity. *See* Gilson & Gordon, *supra* note 176, at 891–92. More importantly, the 2023 banking crisis is a stark reminder that efforts to contain financial stability risk would require a far greater expenditure of resources given the interconnectedness of financial institutions. The crisis represents precisely the type of nondiversifiable financial stability risk at the heart of PVM; yet it was initiated by the failure of just three regional banks (Silicon Valley Bank, Silvergate Bank, and Signature Bank). As of December 31, 2022, the Federal Reserve listed 2,214 banks on its list of "large commercial banks" operating in the United States. *Large Commercial Banks*, FED. RSRV. (Dec. 31, 2022), https://www.federalreserve.gov/releases/lbr/20221231 [https://perma.cc/MZR9-XJ9R]. In addition to firm-specific engagement, Gordon also suggests institutional investors could adopt portfolio-wide policies that favor more specific disclosures regarding a company's exposure to areas of systemic risk, such as through supporting private and quasi-regulatory efforts to provide more uniform disclosure standards on climate change risk. Gordon, *supra* note 84, at 661. Even here, however, the goal would be to facilitate better pricing of a company's securities to reflect a company's exposure to systemic risk. Yet to the extent markets can better price a firm's exposure to a particular type of systemic risk, this simply ensures investors will be compensated for bearing this form of nondiversifiable risk.

portfolio externalities would likely be counterproductive for the value of shareholders' portfolios, given their relatively small role in the PVM objective function and the relatively limited information firm managers have about them. The optimal incentive contract for managers under the PVM approach would thus focus squarely on the long-term value component of the objective function and put little to no weight on technological externalities.[179] Reforms that aim to induce managers to incorporate portfolio effects into their decision-making are likely counterproductive for both diversified portfolio returns and for social welfare.

These considerations help explain why institutional investors have refrained from pushing managers of high carbon-emitting firms to slash emissions in the name of maximizing the value of *other* portfolio firms, as one might expect if investors truly wanted firms to adopt a PVM perspective. On the contrary, to the extent investors evaluate the impact of climate change on portfolio value maximization, they typically focus on the implications of climate change for each firm's long-term value and in particular on transition risks, such as the costs a firm will face as governments seek to rein in carbon emissions and the investment opportunities these efforts will produce.[180]

Indeed, the work of UNEP FI, which was established to advance methodologies for assessing the impact of climate change on the portfolios of institutional investors, is replete with this perspective. Using an investment portfolio consisting of 30,000 global securities, the report's headline results indicate that investors in such a portfolio would face a 13.16% risk of loss due to transition risk, but low carbon-technology opportunities offset these costs by providing 10.74% of potential gains. To be sure, the report also estimated the aggregate physical losses to the portfolio arising from climate change to be 2.14%.[181] Yet even in this regard, the report cited investors as using these methods to engage with companies "to encourage greater climate risk resiliency"—in other words, to ensure companies are looking to maximize firm value in the face of these climate risks.[182] Likewise, to the extent shareholder engagement at Big Oil firms has

179. In the absence of antitrust laws, the optimal incentive contract might also seek to encourage managers to create pecuniary externalities by, for example, colluding with the firm's competitors.

180. *See, e.g.*, BLACKROCK, CLIMATE-RELATED RISK AND THE ENERGY TRANSITION 1 (2023), https://www.blackrock.com/corporate/literature/publication/blk-commentary-climate-risk-and-energy-transition.pdf [https://perma.cc/C69L-ZXJQ] ("While companies in various sectors and geographies may be affected differently by climate change, the energy transition is an investment factor that we expect to be material for many companies and economies around the globe. Within this context, and as stewards of our clients' assets, we engage companies and encourage them to publish disclosures that help their investors understand how they identify and manage the material risks and opportunities related to climate change and the energy transition." (endnote omitted)).

181. UNITED NATIONS ENV'T PROGRAMME FIN. INITIATIVE, *supra* note 117, at 12.

182. *Id.* at 78.

resulted in revised compensation plans to address climate change, the revised plans are uniformly designed to reward management for success in managing transition risk—a broad category of conduct that includes meeting greenhouse gas ("GHG") emissions targets in anticipation of higher carbon costs as well as pursuing alternative energy technologies.[183]

C. DEVOLVING CORPORATE CONTROL TO SHAREHOLDERS

In the prior Section we took as given the current institutional arrangements that give the board of directors control over corporate policy. This model of corporate governance necessarily raises the challenges of how shareholders might convey their preferences to managers (whether to maximize portfolio value or pursue social preferences) as well as how to provide managers with incentives to pursue these preferences. As we have argued, these challenges are difficult—if not impossible—to overcome, so it is hardly surprising that some proponents of shareholder welfarism, from both the SSP and PVM strands, have proposed implementing the shift away from shareholder value maximization toward shareholder welfare maximization by simply giving shareholders much greater direct say in operational matters. This approach is perhaps most associated with two 2022 papers penned by Oliver Hart and Luigi Zingales,[184] but similar admonitions to provide shareholders with greater voice in corporate governance have long emanated from proponents of PVM.[185]

We therefore conclude our evaluation of shareholder welfarism by considering the extent to which devolving corporate control to shareholders might improve corporate conduct. Note that, under this implementation mechanism, the distinction between the SSP and PVM forms of shareholder welfarism becomes less significant: in exercising their control rights over a

183. For instance, in 2021, Chevron approved the addition of an "Energy Transition" performance category to the Chevron Incentive Plan ("CIP") scorecard in response to investor communications. Chevron Corp., 2022 Proxy Statement (Schedule 14A) 44 (Apr. 7, 2022). According to the company, the "new category will have a 10% weighting, and will measure Chevron's progress in the areas of GHG management, renewable energy and carbon offsets, and low-carbon technologies." *Id.* at 49. In addition to the 10% weight provided to this Energy Transition metric, the CIP determines annual awards based on three other areas: financial results (weighted 35%), capital management (weighted 30%), and operating and safety performance (weighted 25%). *Id.* at 45.

184. *See, e.g.*, Broccardo et al., *supra* note 78, at 3101; Oliver Hart & Luigi Zingales, *The New Corporate Governance*, 1 U. CHI. BUS. L. REV. 195 (2022).

185. *See, e.g.*, HAWLEY & WILLIAMS, *supra* note 84, at 144 (proposing that the governance role of institutional investors should reflect the broader powers of ownership in a corporation, including 'actively participating in its strategic direction' "); Wolf-Georg Ring, *Investor Empowerment for Sustainability*, 74 REV. ECON. 21, 21 (2023) ("[F]or investor empowerment as the main tool towards achieving greater sustainability in capital markets" and grounding this "trust in institutional investors . . . in various recent developments both on the supply side and the demand side of financial markets, and also in the increasing tendency of institutional investors to engage in common ownership.").

corporation, shareholders would be motivated by their full range of relevant preferences, including with respect to the value of the firm, the value of other securities in their portfolios, and their social preferences. As such, we refer collectively to scholars taking this particular approach to implementing either SSP or PVM as proponents of "shareholder welfarism."

1. The Economic Logic of Centralized Control

To begin, we note that adopting a more holistic understanding of shareholder interests, as urged by these proponents of shareholder welfarism, does not change the basic economic logic that originally gave rise to the centralized management of publicly traded corporations. Diversified shareholders generally lack the information and expertise needed to run the firm; this is why, under current institutional arrangements, corporate control is vested in an elected board of directors. Put simply, centralized management lets managers be managers and investors be investors, and that specialization of function has well-understood economic benefits. In our view, devolving operational decisions to shareholders of publicly traded corporations would make little economic sense and would result in worse corporate performance, not just in terms of shareholder value but even in shareholder welfare or social welfare terms.

2. Determining Which Decisions to Devolve to Shareholders

To be sure, proponents of shareholder welfarism do not propose that *all* operational decisions be devolved to shareholders, presumably in large part because they recognize the value, indeed practical necessity, of a significant degree of centralization of control over public companies in professional managers. But what then determines which operational decisions are made by shareholders and which by managers? Hart and Zingales argue that, as a conceptual matter, shareholders be given a direct say only with respect to operational issues that implicate a social goal that the company has a comparative advantage in achieving.[186] They offer as an example a case from 1984 when DuPont faced a choice between polluting the Ohio River or spending money to avoid doing so.[187]

But identifying conceptually a class of decisions that should be delegated to shareholders is on its own not enough. One must also specify who decides on a day-to-day basis when a particular corporate decision meets the specified criteria for devolution to shareholders. One possibility is that management decides. We suspect, however, that such an arrangement

186. Hart & Zingales, *supra* note 184, at 210.
187. *Id.* at 210–11.

would result in management rarely bringing matters to a shareholder vote, given the time and expense involved and the fact that shareholders are so poorly equipped to make such decisions. It is not clear why management would have any incentive to bring such votes, and enforcement of a legal obligation for them to do so would presumably entail suits brought by shareholders, in effect making shareholders the key actors in instigating these shareholder votes over corporate operations.

Accordingly, the only plausible approach is to let shareholders initiate such votes, perhaps with management having access to a legal procedure for refusing to bring the vote if it does not meet the specified legal criteria.[188] This is how the process for putting precatory shareholder proposals on management's proxy statement for the annual shareholder meeting generally works currently under Rule 14a-8. But consider the incentives of shareholders to initiate such interventions. Standard collective action problems would inhibit diversified individual shareholders from bearing the considerable costs of putting operational issues to a shareholder vote. Similarly, traditional asset managers likely have little incentive to bear the costs of intervening by sponsoring shareholder proposals.[189]

Consistent with this analysis, existing evidence on precatory shareholder proposals on social issues shows they are proposed largely by what Roberto Tallarita calls "stockholder politics specialists": policy advocacy organizations like As You Sow, socially responsible investment advisors like Domini Impact Investments, and public and union pension funds.[190] These specialists generally have particular social and political agendas that existing scholarly commentaries characterize as different from the interests of most of the shareholder base.[191] It seems likely that these actors often make proposals designed not to push corporate managers to strike a trade-off desired by shareholders between firm value and shareholders' other preferences (which would be consistent with the view taken by proponents of shareholder welfarism), but rather they make proposals aimed at advancing a particular political agenda. In line with that understanding, only 3.3% of shareholder proposals on social issues from 2010 to 2021 received majority shareholder support.[192]

188. This is how Hart and Zingales propose to implement SSP. *Id.* at 215.

189. *See* Gilson & Gordon, *supra* note 176, at 894.

190. Roberto Tallarita, *Stockholder Politics*, 73 HASTINGS L.J. 1697, 1740–42 (2022).

191. *See, e.g.*, Susan W. Liebeler, *A Proposal to Rescind the Shareholder Proposal Rule*, 18 GA. L. REV. 425, 439 (1984); Roberta Romano, *Public Pension Fund Activism in Corporate Governance Reconsidered*, 93 COLUM. L. REV. 795, 807 (1993).

192. Tallarita, *supra* note 190, at 1719. This fraction increased dramatically at the end of the sample period, however, reaching 12.4% in 2019 and 19.2% in 2021. *Id.* at 1727. Specific categories of social proposals that have begun attracting majority shareholder support at greater rates include proposals on

We would expect these same actors to be the primary proponents of shareholder proposals under the reforms urged under the shareholder welfarism view that would make shareholder proposals on operational issues binding. The key question is whether empowering these actors to initiate shareholder decisions that override management through binding shareholder resolutions on operational matters is likely, on net, to improve corporate behavior.

3. The Nature of Shareholder Preferences over Operational Decisions

Consider now how shareholders would vote on proposals pertaining to operational decisions. In an influential article published in the *Journal of Political Economy*,[193] which we will refer to as BHZ, Eleonora Broccardo, Oliver Hart, and Luigi Zingales develop a model of shareholder voting and derive a startling result: in voting over operational decisions that pose trade-offs between firm value and social concerns, diversified shareholders will ignore the implications of the decision for their own investment returns and instead view the decision exactly as a social planner would, making the decision on the basis of the net social benefits to society as a whole.[194] They thus show that, under their assumptions, if a majority of shares are held by investors who are even slightly socially responsible, letting shareholders decide on operational matters achieves the socially optimal outcome. If their model provides a good account of shareholder voting behavior, then devolving operational decision-making to shareholders would have enormous potential for improving corporate conduct. Specialist actors with various views on social issues implicated by corporate conduct could tee up a range of binding resolutions for shareholders to vote on, and shareholders would pass them if and only if they improve social welfare.

But BHZ's stark result depends on a set of critical assumptions and seems to us implausible in practice. BHZ models investors' utility from owning a stock as having two components: one stemming from their investment returns from the stock and an altruistic component stemming from how the company's operations affect society.[195] BHZ assumes that, because any individual stock would make up a de minimis fraction of a perfectly diversified investor's portfolio, such an investor would have no (or de minimis) concern about the effect of an operational decision on their own

board diversity, climate-related proposals, and proposals on corporate political activity. EY CTR. FOR BD. MATTERS, ERNST & YOUNG, WHAT BOARDS SHOULD KNOW ABOUT ESG DEVELOPMENTS IN THE 2021 PROXY SEASON 3–4 (2021).

193. Broccardo et al., *supra* note 78, at 3101.

194. *Id.* at 3115.

195. *Id.* at 3113–14.

investment returns.[196] On the other hand, BHZ assumes that diversification has no effect on the strength of an investor's ethical concerns about the company's behavior.[197] This asymmetry in their treatment of the effects of diversification is the key behind their result that each investor would vote on operational decisions just like a social planner would.

A natural alternative model of investor psychology is from earlier work by Hart and Zingales in which they assumed that the level of responsibility that shareholders feel for corporate externalities scales with their holdings in the firm.[198] Under that assumption, investors would vote on operational matters by trading off the effects of the decision on firm value and on social considerations, with the weight on social considerations depending on the strength of their social preferences (which would reflect their financial position in the firm), in much the same way as we characterized aggregate shareholder welfare in Section IV.A above. Which of these models best captures how investors would actually think about binding shareholder proposals on operational matters cannot be derived through purely deductive reasoning but rather is ultimately an empirical question, which we return to below.

A second key assumption of BHZ concerns the effect of diversification on investors' incentives to become informed about votes. An individual investor's probability of casting the pivotal vote that determines the outcome goes to zero as they become perfectly diversified, for the same basic reason that their interest in the returns on any particular company's stock goes to zero. This latter effect of diversification plays a key role in BHZ's analysis, as we have discussed, but with regard to the former, BHZ assumes that "shareholders will vote as if they were pivotal since this is the only case where their vote matters; in other words, they vote the outcome they would like to occur."[199] But a more consistent view about the effects of portfolio diversification is that there would be no reason for an individual investor to give a moment's thought or attention to how to vote shares or to potential investment funds' voting policies, because in the limit an individual

196. *Id.* at 3115. Of course, the assumption of perfectly diversified, atomistic shareholders is inconsistent with how many shares are held, but we put that objection to the side.

197. Mathematically, BHZ denotes the number of firms in a diversified portfolio as r and uses a utility function in which the investment returns term is multiplied by $1/r$, but the social preferences term is not multiplied by $1/r$. As a result, in the limit as r becomes very large, the investment-returns term goes to zero so that all that is left is the term representing the investor's social preferences. *Id.* at 3115.

198. Hart & Zingales, *supra* note 71, at 253 n.14 ("We suppose that a consumer feels responsible for the share of social surplus corresponding to his shareholding in order to avoid a situation where the social surplus term overwhelms the profit term for a small shareholder."). In mathematical terms, this is equivalent to changing the utility function in BHZ by multiplying the social preferences term as well as the investment returns term by $1/r$.

199. Broccardo et al., *supra* note 78, at 3114.

shareholder has no effect on the world.[200] The prediction of the model would then not be that each investor acts like a social planner but rather widespread rational investor apathy about shareholder votes and about how funds vote, even for socially minded investors.[201]

Perhaps the best evidence for evaluating the predictions of BHZ is from shareholder voting on a major class of operational decisions on which shareholders currently are given a binding vote: mergers. Corporate mergers implicate both investors' investment returns as well as a range of social concerns, including those stemming from increased market power and with respect to the effect of the merger on various classes of firm stakeholders, such as employees and creditors. The model of BHZ predicts that investor voting on mergers would be based not on their own investment returns but rather on such social issues. In short, shareholders would vote for mergers only to the extent they improved social welfare and against mergers that impaired social welfare, regardless of the financial return shareholders could expect from the merger. It is, of course, a claim that calls into question the need for any oversight of mergers on public policy grounds (for example, through antitrust review) as this work would be accomplished through the shareholder vote.

Not surprisingly, this prediction is belied by the evidence: the main concern among shareholders in controversial merger votes is, to our knowledge, never about market power or the effects on other corporate constituencies but rather about the *deal price*. As an example, consider Michael Dell's 2013 leveraged buyout of Dell, Inc. When originally proposed, the deal—like many management buyouts—attracted substantial shareholder opposition based on the concern that shareholders were being offered too low of a price, leading Michael Dell to sweeten the deal by offering a special dividend to shareholders.[202] Deal price is a purely distributive concern that implicates investors' returns; if shareholders cared

200. *Cf.* Brav et al., *supra* note 161, at 505 (finding a positive empirical relation between a retail investor's ownership position in a company and the likelihood that the investor casts a ballot at the company's annual shareholder meeting).

201. And these objections do not exhaust the set of critical assumptions that BHZ relies on for their result. For example, their result also hinges on specific choices about the cost structure of the corporate action being voted on ("adopting a technology"). BHZ assumes that the action entails only fixed costs and has no effect on marginal costs. But if it were to increase firms' marginal costs, then under perfect competition the result would only obtain if all firms adopted it at once. If some firms do not adopt, then the remaining dirty firms would win the entire market. In turn, in equilibrium consequentialist shareholders would no longer view adopting the technology as actually reducing the externality. Their additional assumption of fixed capacity constraints might avoid this problem to some extent, but that represents still another example of how, in our view, BHZ relies on very strong assumptions.

202. *See* David Benoit & Sharon Terlep, *Dell Reaches New Deal with Founder*, WALL ST. J. (Aug. 2, 2013, 7:34 PM ET), https://www.wsj.com/articles/SB10001424127887324635904578643491233202754 [https://perma.cc/BJ8F-8S5T].

only about the social welfare effect of a merger, this distributive concern would be irrelevant. It is difficult to reconcile the centrality of concerns about deal price in shareholder voting about mergers—as opposed to concerns about market power or treatment of other corporate constituencies—and BHZ's model of voting on operational decisions. In contrast, this outcome is consistent with our analysis in Section IV.A above that the overwhelming driver of shareholder welfare under the SSP view is firm value, not shareholders' social preferences.

4. The Benefits of Devolving Control to Stockholders

What then would be the benefits, in terms of improved corporate conduct, of devolving control to stockholders? In our view they would be negligible, for the same basic reasons we gave in evaluating the objective functions under SSP and PVM and their feasibility for corporate managers in Sections IV.A and IV.B. We will not recapitulate all of those arguments here, but in short, the predominant consideration that would drive shareholder voting on operational matters would be firm value, not broader social concerns or portfolio externalities. To the extent shareholders' social preferences did factor into their voting on operational matters, they would entail a form of stated preferences based on the limited information available to shareholders about the full consequences of the vote on a firm's operations. As such, they would not serve as a reliable guide to shareholders' revealed preferences about social issues or to social welfare.

While it might be hoped that such a devolution would at least facilitate low-hanging-fruit improvements to corporate behavior—changes that would attract widespread agreement in society—such issues are those that are most likely to be addressed already by law and public policy. Putting operational matters to a shareholder vote involves deploying a type of political mechanism—what Roberto Tallarita refers to as "stockholder politics"—as an alternative to traditional politics.[203] But by our lights, stockholder politics is likely to be much *less* protective of broader social interests than traditional politics since corporate stockholders are a subset of the broader polity and this subset of voters owns the claims to the corporate profits that would have to be sacrificed in service of those broader interests.

5. The Costs of Devolving Control to Stockholders

While the social benefits from devolving control to stockholders would be negligible, the social costs would likely be significant. Those costs would come in three main forms. First, allowing shareholders to propose binding

203. Tallarita, *supra* note 190, at 1701.

resolutions on corporate conduct would result in substantial distraction of management, which would inevitably be drawn into defending corporate policies against social activists pushing for reforms. As we have emphasized previously, managers have a finite amount of time and attention so that this distraction would result in worse corporate performance over time. Second, devolving control to shareholders risks changes to corporate policy that are likely to reduce the well-being of shareholders and the broader society. That is, one cannot be confident that all successful shareholder interventions would ultimately be in shareholder interests, given the many layers of intermediation between beneficial owners and the shares as well as the limited amount of information shareholders would inevitably have about the full costs and benefits of a proposed change in a firm's operations in this decision-making environment.[204] Finally, as other scholars have noted, turning to shareholder voting in hopes of regulating the production of technological externalities comes with troubling political implications. These include the possibility of chilling the perceived need for systematic legislation and regulation,[205] the effective weighting of shareholders' policy preferences by their wealth,[206] and the vesting of *de facto* regulatory power in the hands of a few unelected asset managers given the prevailing distribution of voting power in corporate elections.[207]

V. THE FUTURE OF CSR IS ESV

Shareholder governance holds significant promise for improving corporate social responsibility. But this promise does not stem from any innovation in our basic understanding of shareholders' interests along the lines of shareholder welfarism. Indeed, we have argued that changing the corporate objective in the ways urged by shareholder welfarism would fail to meaningfully improve corporate conduct and might even do the opposite.

204. Zohar Goshen and Richard Squire term the costs that occur when investors exercise control "principal costs," a play on "agency costs." Zohar Goshen & Richard Squire, *Principal Costs: A New Theory for Corporate Law and Governance*, 117 COLUM. L. REV. 767, 771 (2017). Similarly, Iman Anabtawi argues that giving shareholders more power over operational matters would distort corporate decisions due to the influence of large shareholders with interests that conflict with shareholders' interests as a class. Iman Anabtawi, *Some Skepticism About Increasing Shareholder Power*, 53 UCLA L. REV. 561, 561 (2006).

205. *See* Bebchuk & Tallarita, *supra* note 2, at 168–73.

206. Marcel Kahan & Edward B. Rock, *Corporate Governance Welfarism*, 15 J. LEGAL ANALYSIS 108, 123 (2023).

207. *See* Condon, *supra* note 85, at 8 ("Beyond a mere tallying of positive and negative economic outcomes, the role of investor as private regulator should raise concerns about the compatibility of concentrated corporate control with democratic society—concerns dating back at least as far back as Adolf Berle and Gardiner Means."); Dorothy S. Lund, *Asset Managers as Regulator*, 171 U. PA. L. REV. 77, 77–78 (2023) (arguing that asset managers effectively supply regulation on matters pertaining to social and environmental matters and highlighting the lack of democratic accountability and government oversight for their policymaking).

Rather, the ongoing promise of shareholder governance for CSR stems from the prospect of further reductions in certain agency costs and information problems based on the traditional corporate objective, long-term shareholder value. We suspect that there remain opportunities for corporate management to reform firm policies in ways that both increase shareholder value and improve the firm's social performance, perhaps by addressing the information and incentive problems of ESV we have discussed. But ESV is often misunderstood in the law-and-economics literature. In this final part we begin by addressing those misconceptions and clarifying what we believe to be the most useful understanding of ESV. We then briefly describe an episode at ExxonMobil that illustrates recent innovations in the use of ESV arguments by market actors and the potential promise that ESV holds for advocates of CSR. We conclude this part by identifying a set of key questions about ESV that we think form an important research agenda for the field.

A. CLARIFYING ESV AS A CONCEPT

Despite its surging popularity in the business world, ESV has received little sustained analysis in legal scholarship. What attention it has received from legal scholars largely reflects one or both of two misconceptions about ESV that we seek to clarify here.

First, some shareholder primacy theorists misconceive ESV as an alternative to traditional shareholder value as a corporate objective.[208] For example, in a recent paper Lucian Bebchuk, Kobi Kastiel, and Roberto Tallarita examine "the view that corporations should replace their traditional purpose of shareholder value maximization (SV) with a standard commonly referred to as 'enlightened shareholder value' (ESV)."[209] After arguing that SV and ESV are operationally equivalent, they conclude that "replacing SV with ESV should not be expected to produce benefits for either shareholders or society."[210]

208. *See, e.g.*, Bebchuk et al., *supra* note 42, at 732; Lund, *supra* note 9, at 94 (contrasting the "traditional" shareholder wealth maximization standard with the "enlightened shareholder value standard"). Relatedly, some CSR-oriented scholars treat ESV as a form of stakeholderism that ultimately requires corporate actions that sacrifice shareholder wealth to further stakeholder interests. Virginia Harper Ho, *"Enlightened Shareholder Value": Corporate Governance Beyond the Shareholder-Stakeholder Divide*, 36 J. CORP. L. 59, 98 (2010) ("[I]t is in the cases . . . 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 . . . . 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."). This is not what we refer to as ESV in this Article.

209. Bebchuk et al., *supra* note 42, at 732.

210. *Id.* at 3.

But their framing of ESV as an alternative corporate objective is, in our view, a category mistake. ESV is not an alternative corporate objective. The enlightenment that ESV calls for involves not an adjustment of the corporate objective itself but rather in how to seek it. ESV is best understood as a reform agenda targeting a particular class of agency costs and information problems that harm not only shareholders but also other corporate stakeholders. Just as one might usefully analyze problems with the design of executive compensation as a distinctive manifestation of and contributor to managerial agency costs,[211] ESV theory identifies a particular class of agency and information problems worthy of study that might point to their own set of interventions.

Why have law-and-economics scholars instead viewed ESV as advancing an alternative corporate objective? This framing of ESV might stem in part from the grammatical structure of the label: "enlightened" is an adjective, modifying "shareholder value." Another reason—suggested by Bebchuk and coauthors[212]—is that some jurisdictions have added explicit language to corporate statutes highlighting the importance of operating in a socially responsible manner to the achievement of shareholder value. For example, the United Kingdom Companies Act provides

> A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its [shareholders] as a whole, and in doing so have regard (amongst other matters) to— . . .
>
> (b) the interests of the company's employees,
>
> (c) the need to foster the company's business relationships with suppliers, customers and others,
>
> (d) the impact of the company's operations on the community and the environment,
>
> (e) the desirability of the company maintaining a reputation for high standards of business conduct.[213]

But such a provision does not change the corporate objective from maximizing shareholder value. Rather, we suspect that the existence of stakeholderism as a competing conception of corporate purpose may explain the perceived need to add explicit language endorsing such CSR considerations in pursuing long-term shareholder value. After all, many people believe in stakeholderism, which is indeed a fundamentally different understanding of ends, and not just means, of the corporate form. This leads to several phenomena that might in turn justify explicit acknowledgement of

211. *See, e.g.*, LUCIAN BEBCHUK & JESSE FRIED, PAY WITHOUT PERFORMANCE 4-5 (2004).
212. Bebchuk et al., *supra* note 42, at 736.
213. Companies Act 2006, c. 46, § 172(1) (UK).

ESV considerations in corporate law.

First, when good faith managers sacrifice short-term profits to act more responsibly in ways that further shareholder value, they might be accused of being stakeholderists! Explicit legal endorsement of ESV can reassure all involved that engaging in CSR is often required to further shareholder value. Second, one could interpret explicit ESV legal language as limiting rather than permissive; it can make clear to corporate managers that they should pursue CSR *only* to the extent that it furthers shareholder value. This is what the Delaware Supreme Court did in the *Revlon* case ("A board may have regard for various constituencies in discharging its responsibilities, provided there are rationally related benefits accruing to the stockholders.").[214] Finally, stakeholderists often propagate a caricature of shareholder value theory in which fat-cat capitalists squeeze every last penny out of workers and customers, pollute the environment at will, and otherwise act in outrageous ways all in pursuit of immediate profit.[215] Legal endorsement of ESV helps combat that distorted view of shareholder primacy.

A second misconception about ESV is that it is useless because the behavior of all the key actors in the corporate system is determined by their incentives and so ESV ideas cannot improve it. One version of this critique focuses on the significant extent to which existing corporate governance institutions already provide substantial incentives for management to maximize shareholder value, including through practices that also further stakeholder interests, which raises the question of whether there remain any such opportunities not yet exploited. As Elhauge puts it, "Agitating for corporations to engage in responsible conduct that increases their profits is a lot like saying there are twenty-dollar bills lying on the sidewalk."[216]

Quite the contrary. For one, the mechanisms posited by ESV often involve substantial uncertainty as to how best to maximize long-term shareholder value.[217] That uncertainty is in part a function of the long time horizon over which the firm will receive the ultimate financial benefits of socially responsible conduct. In contrast, the financial costs of such practices are typically both immediate and certain. As a result, there is no reason to think that all such positive NPV investments in social responsibility will be exploited. In many cases, firm managers will simply make mistakes in

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

215. *See, e.g.*, LYNN STOUT, THE SHAREHOLDER VALUE MYTH: HOW PUTTING SHAREHOLDERS FIRST HARMS INVESTORS, CORPORATIONS, AND THE PUBLIC vi, 3, 7, 11 (2012) ("Conventional shareholder value thinking . . . . causes companies to indulge in reckless, sociopathic, and socially irresponsible behavior . . . . In the quest to 'unlock shareholder value' [directors and executives] sell key assets, fire loyal employees, and ruthlessly squeeze the workforce that remains.").

216. Elhauge, *supra* note 41, at 744–45.

217. EDMANS, *supra* note 43, at 60.

striking these uncertain intertemporal trade-offs. These mistakes, moreover, might be systematically biased toward social irresponsibility, given the asymmetry that poses certain, immediate costs against uncertain, future benefits of more responsible conduct.[218] More fundamentally, management might face conflicts of interest that produce agency costs in the form of inefficiently irresponsible corporate conduct.[219] As we have explained, the ESV approach is best understood as largely involving concern about a genus of agency costs in the short-termism family.[220] The key conceptual challenge for ESV theory is thus not how to explain all the cash on the sidewalk but rather to identify governance reforms or other interventions that might realistically reduce these agency costs and produce more cash.

In that vein, a second version of this critique of ESV takes a glass-half-empty perspective on management incentives. For example, Bebchuk and his coauthors argue that, to the extent that managers fail to engage in shareholder-value-maximizing CSR due to incentive problems that lead to short-termism, ESV offers no way out. As they put it: "[A]s long as corporate leaders have short-term incentives, pontificating to them about the importance of taking into account long-term effects, either in general or with respect to stakeholders in particular, would not address short-termism problems."[221]

Their claim exemplifies what economists have termed the "determinacy paradox."[222] This problem arises when an analyst has a positive model of the actors in a system that generates predictions about how those actors *will* behave, but then nonetheless engages in normative arguments about how those actors *should* behave.[223] If the analyst believes that the actors' behavior is pinned down by the positive model, what exactly is the point of the normative arguments? That is the logical structure of Bebchuk and his coauthors' critique, and it does indeed pose an important challenge for ESV

218. To be clear, the existence of such a systematic bias is not self-evident, nor is it fundamental to our argument. All that is necessary to make ESV of interest is that there exist unrealized opportunities to reform corporate policy in ways that further both shareholder interests and CSR, not that there are more such cases than there are cases in which corporations engage in excessive CSR from a shareholder value perspective.

219. Note that this can be the case even when there are other conflicts of interest that might result in management sometimes acting *excessively* responsibly from a shareholder value perspective. ESV as we define it focuses on eliminating inefficient corporate irresponsibility. One could imagine another reform agenda that focuses on eliminating inefficient corporate responsibility, which we might term "anti-stakeholderism." In principle these two reform agendas need not be in conflict with one another.

220. *See infra* Section IV.B.1.

221. Bebchuk et al., *supra* note 42, at 748.

222. Brendan O'Flaherty & Jagdish Bhagwati, *Will Free Trade with Political Science Put Normative Economists Out of Work?*, 9 ECON. & POL. 207, 208 (1997).

223. *Id.* at 208.

theory.

But note that, as a preliminary matter, this basic challenge for ESV theory is shared by all normative arguments in corporate law scholarship. Economic analysis of corporate law relies on a rich set of positive models that explain the behavior of key actors in the system—officers, directors, shareholders, and the like. But in addition to all of their positive theorizing, corporate law scholars have a decidedly reformist bent. After diagnosing some set of pathologies in the corporate system, generally with the aid of a positive model, the typical scholarly article about corporate law then turns to reform proposals that aim to remedy the problem.[224] But if all of the relevant decisionmakers' behavior is pinned down by incentives, what is the point of this pontificating? If the positive model is right, then why would managers or directors, for example, care about the analyst's normative arguments? This is a challenge even for normative arguments about what the law should be, since positive models in corporate law scholarship purport to explain even the content of corporate law itself, for example as the inevitable outcome of state competition for charters.[225] The generality of this analytic challenge for normative arguments in corporate law scholarship has not previously been recognized.[226]

Are all normative arguments about corporate governance hopeless then? Thankfully, no. The way out of the paradox is to identify some set of actors that might ultimately be persuaded by the normative argument. The ability to persuade an actor in turn typically requires that the actor have both something to learn and incentives that align to some degree with the recommendation.[227] Rather than leading to normative nihilism, the determinacy paradox should instead discipline us as corporate law scholars to be more explicit about the audiences we have in mind for our normative

224. *See, e.g.*, Lucian A. Bebchuk, *The Case for Facilitating Competing Tender Offers*, 95 HARV. L. REV. 1028, 1030 (1982) ("[F]acilitating competing tender offers is desirable both to targets' shareholders and to society."); Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 837–38 (2005) ("Part III presents the case for giving shareholders the power not only to elect and replace directors, but also to initiate and adopt rules-of-the-game decisions to amend the corporate charter or to reincorporate in another jurisdiction . . . . [It] also provides empirical evidence of management's ability to avoid rules-of-the-game changes that are viewed as value-enhancing by a majority of shareholders.").

225. *See, e.g.*, Roberta Romano, *The State Competition Debate in Corporate Law*, 8 CARDOZO L. REV. 709, 712–25 (1987) (reviewing positive models of state corporate law based on competition for corporate charters).

226. In contrast this challenge has been discussed extensively in public law scholarship. *See, e.g.*, Eric A. Posner & Adrian Vermeule, *Inside or Outside the System?*, 80 U. CHI. L. REV. 1743, 1749 (2013) (arguing that public law scholarship commonly suffers from the determinacy paradox insofar that it combines "pessimism about diagnoses with unexplained optimism about solutions").

227. O'Flaherty & Bhagwati, *supra* note 222, at 215.

arguments and to explain why—despite our rich positive models—those arguments command attention. We need an unmoved mover in the system who might be open to the normative argument in order for it to make a practical difference.

Two key audiences who often play that role in corporate law scholarship, more or less explicitly, are institutional investors and government officials. To give one illustrative example, consider Lucian Bebchuk and Jesse Fried's incisive book on executive pay.[228] They argue that a range of common practices in executive pay stem from, and contribute to, managerial agency costs.[229] For this analysis to deliver a practically useful normative payoff, however, requires there to be an audience for their arguments that might be influenced in such a way that the design of executive compensation improves. The authors argue in part that "[t]his is an area in which the very recognition of problems may help alleviate them," asserting that "[m]anagers' ability to influence pay structures depends on the extent to which the resulting distortions are not too apparent to market participants—especially institutional investors."[230] But they also advocate policy changes that would shift power from boards to shareholders, arguing that

> [f]or there to be changes in the allocation of power between management and shareholders, investors' demand for them must be sufficient to outweigh management's considerable ability to block reforms that chip away at its power and private benefits. This can happen only if investors and policymakers recognize the substantial costs that current arrangements impose—as well as the extent to which solving existing problems requires addressing the basic problem of board unaccountability. We hope that this book will contribute to such recognition.[231]

The determinacy paradox strikes us as easier to surmount for normative arguments in ESV theory than it typically is in corporate governance theory more generally. After all, ESV theory, by definition, pushes for reforms that are in the interests of both shareholders and other stakeholders so that multiple classes of actors in the system have interests that are to some degree aligned with the reform to corporate practice being urged and might therefore

228. BEBCHUK & FRIED, *supra* note 211.

229. *Id.* at 45–95.

230. *Id.* at 12.

231. *Id.* at 216. But at times the authors leave the identity of the policymaker being appealed to unspecified. *See id.* at 213. For example, after pointing out that "states seeking to attract incorporating and reincorporating firms have had incentives to give substantial weight to management preferences, even at the expense of shareholder interests," the authors write,

> Giving shareholders the power to initiate and approve by vote a proposal to reincorporate or to adopt a charter amendment could produce, in one bold stroke, a substantial improvement in the quality of corporate governance. Shareholder power to change governance arrangements would reduce the need for intervention from outside the firm by regulators, exchanges, or legislators.

Id. But the identity of the policymaker who they hope will do the "giving" is left unspecified. *See id.*

play a role in helping to bring it about.

Normative ESV arguments by academics, for example, might usefully target a range of audiences in the corporate system. Consider Alex Edmans's 2020 book, *Grow the Pie*, which seems primarily aimed at teaching *managers* how focusing on the social value created by the firm is a surer path to shareholder value creation than seeking shareholder value directly.[232] The book provides a lucid account of the relevant empirical literature on these issues that we suspect has important lessons for managers and independent directors. Institutional investors might also benefit from his analysis and be persuaded to adjust their approach to using ESG factors in their investment process. This could well be an area in which clearer recognition of the agency cost problems that deter managers from considering social value may help alleviate them, as Bebchuk and Fried assert about executive compensation.[233] And to the extent that failures to exploit all opportunities to engage in CSR in ways that benefit stockholders stem from mistakes due to limited information, the potential for ESV arguments to make a difference is even more straightforward.

In sum, the Panglossian argument that nobody could possibly have a useful new idea along the lines of ESV because if it were incentive compatible to adopt a practice that improved CSR in ways that benefit shareholders, corporations would already be doing it, proves too much. As well, as a positive matter, the increase in the use by various actors in the corporate system of normative arguments about corporate practices that sound in ESV terms is by our lights a phenomenon worth studying rather than simply dismissing. Consider, for example, the ESV argument advanced by Blackrock's Larry Fink in his 2022 *Letter to CEOs*: "In today's globally interconnected world, a company must create value for and be valued by its full range of stakeholders in order to deliver long-term value for its shareholders."[234] The audiences for this argument include independent directors, managers, and other investors.

More concretely, the 2021 activist intervention at ExxonMobil by the hedge fund Engine No. 1 similarly illustrates the potential promise ESV holds for CSR. In the spring of 2021, Engine No. 1 initiated a proxy fight based on a platform that was heavily critical of the Exxon's failure to grapple with the reality of a rapidly decarbonizing world.[235] Critically, however, its

232. EDMANS, *supra* note 43, at 23–37.

233. BEBCHUK & FRIED, *supra* note 211, at 12.

234. Fink, *supra* note 101.

235. For the history of Engine No. 1's proxy fight, see Jessica Camille Aguirre, *The Little Hedge Fund Taking Down Big Oil*, N.Y. TIMES MAG. (June 23, 2021), https://www.nytimes.com/2021/06/23/magazine/exxon-mobil-engine-no-1-board.html [https://perma.cc/5N2J-CBFD]. From the start,

central argument was that management's failure to cut back on investment in oil production was bad for business, not just bad for the earth.[236] However, with a stake amounting to a mere 0.02% of Exxon's shares outstanding,[237] Engine No. 1 had to win the votes of other institutional investors in order to succeed. In this regard, it reflected precisely the type of challenge faced by proponents of ESV ideas: namely, how could it convince other investors that Exxon was somehow failing to see how its existing policies were destroying long-term shareholder value? Consistent with our analysis of the limits of ESV, the answer was through highlighting a lack of information[238] and a lack of incentives[239] among Exxon's management. In the end, its message

Engine No. 1 emphasized the central importance of climate change and decarbonization for the campaign. As it stated in its opening salvo to Exxon, "It is clear . . . that the industry and the world it operates in are changing and that ExxonMobil must change as well." Engine No. 1 LLC, *Letter to the Board of Directors*, REENERGIZE EXXON (Dec. 7, 2020), https://reenergizexom.com/materials/letter-to-the-board-of-directors [https://perma.cc/6R2G-32HP].

236. Exxon Mobil Corp., *supra* note 235. As the fund emphasized when it launched its campaign, the company's total shareholder return over the past ten years had been -20%, compared to 277% for the S&P 500, and it also trailed its industry peers. *Id.* In its investor presentation, Engine No. 1 argued that the stock's lackluster performance reflected a fundamental failure at the company to adjust its business strategy to account for long-term demand uncertainty for oil and gas. In particular, Exxon's long-term business planning "centered narrowly on projections of oil and gas demand growth for decades," *see* Exxon Mobil Corp., Proxy Statement (Schedule 14A) 21 (Mar. 15, 2021), leading it to pursue "aggressive capital expenditure plans to chase production growth" that have left "ExxonMobil far more exposed than peers to demand declines," *id.* at 9. Additionally, Engine No.1 emphasized that the company's "refusal to accept that fossil fuel demand may decline in decades to come has led to a failure to take even initial steps towards evolution." *Id.* at 6. In this regard, Engine No. 1 excoriated the company for its "total reliance on [the] hope of carbon capture to preserve [its] business model," *id.* at 21, which had caused the firm to lack any "credible plan to protect value in an energy transition," *id.* at 14. This failure to grapple with transition risk was in contrast to its peers who "have shown it is possible to begin gradually diversifying – and embracing long-term total emissions reduction targets – while maintaining focus on core business profitability." *Id.* at 27.

237. Matt Phillips, *Exxon's Board Defeat Signals the Rise of Social-Good Activists*, N.Y. TIMES (June 9, 2021), https://www.nytimes.com/2021/06/09/business/exxon-mobil-engine-no1-activist.html [https://perma.cc/XM32-J3YY].

238. For instance, Engine No. 1 argued that the "[b]oard of ExxonMobil will be addressing the most important questions facing the energy industry for years to come," Exxon Mobil Corp., *supra* note 235, at 73, but stunningly, not one of ExxonMobil's independent directors had any prior energy industry experience, *id.* at 19 ("Prior to our campaign, ExxonMobil's Board had no independent directors with [prior] energy experience."). It was for this reason that Engine No. 1 advanced a director slate that could provide the expertise that it believed the "[b]oard has been missing – directors with diverse yet highly relevant backgrounds who have successfully tackled energy industry challenges and bring decades of experience in conventional and alternative forms of energy to help best position ExxonMobil for greater long-term value creation." *Id.* at 73; *see also FAQs*, REENERGIZE EXXON https://reenergizexom.com/faqs [https://perma.cc/3SW5-FS9T] ("The four highly qualified, independent individuals we have identified can bring to the ExxonMobil Board much-needed experience in value-creating, transformational change in the energy sector.").

239. For instance, Engine No. 1 criticized the company's compensation plans for creating "misaligned incentives." Exxon Mobile Corp., *supra* note 235, at 57. It also emphasized the inverse relationship between management compensation and stock performance, arguing that the "[d]isconnect results in part from compensation plans that can reward volumes over sustainable value." *Id.* at 59. In contrast to its peers, Engine No. 1 noted that ExxonMobil provided little disclosure regarding how managers were held accountable for cost overruns. *Id.* Nor did the company follow its peers in utilizing

resonated with a critical audience of institutional investors,[240] allowing Engine No. 1 to win a contested director election to place three new directors on the board of ExxonMobil.

To be clear, we are not arguing that Engine No. 1 was *correct* in its critique of Exxon's management on shareholder value grounds. Exxon's management heavily disputed that claim, and we remain agnostic. Our claim instead is that the intervention was framed in ESV terms, and the key deciders—large institutional investors—appear to have evaluated Engine No. 1's candidates based on shareholder value considerations.

B. A RESEARCH AGENDA FOR ESV

We conclude by briefly outlining a set of research questions about ESV that we think would shed light on the ultimate scope for further improvements to CSR through ESV-motivated reforms and that we hope future scholarship will address.

a management scorecard with "well defined weights for metrics and targets" that were tied to energy transition risk. *Id.* at 60; *see also id.* at 70 (providing examples of "many peer compensation metrics [that] have evolved to incentivize management to create value by looking at the energy transition as an opportunity"). Instead, the company often resorted to "ad hoc" changes to its compensation plans to encourage investment. *Id.* at 60. As a result, Engine No. 1 argued, "In the same way that ExxonMobil's changes to incentive plans to reward production led to a focus on growth even as returns declined, we believe the lack of material energy transition metrics could discourage a focus on the future." *Id.* at 70.

240. Phillips, *supra* note 237 ("The tiny firm wouldn't have had a chance were it not for an unusual twist: the support of some of Exxon's biggest institutional investors."). Many of these investors expressly acknowledged the ESV-oriented arguments advanced by Engine No. 1. For instance, in statements explaining their support for the dissident board candidates, institutional investors concurred with Engine No. 1's critique of the company's performance, particularly its approach to capital allocation, and its "long-term financial underperformance" relative to its industry peers. Cal. Pub. Emp.'s Ret. Sys., SEC Shareowner Alert - Notice of Exempt Solicitation (Form PX14A6G) 1 (May 10, 2021); STATE ST. GLOB. ADVISORS, 2021 PROXY CONTEST: EXXON MOBIL CORPORATION (XOM) 1 (2021). Investors also expressed concern about the "board dynamics" highlighted by Engine No. 1, particularly its lack of information, with Vanguard highlighting "concerns about the lack of energy sector expertise in its boardroom," VANGUARD GRP., INC., VOTING INSIGHTS: A PROXY CONTEST AND SHAREHOLDER PROPOSALS RELATED TO MATERIAL RISK OVERSIGHT AT EXXONMOBIL 2 (2021), https://corporate.vanguard.com/content/dam/corp/advocate/investment-stewardship/pdf/perspectives-and-commentary/Exxon_1663547_052021.pdf [https://perma.cc/JH6Z-5DLT], and BlackRock stating the board would benefit from "the addition of diverse energy experience," BLACKROCK, VOTE BULLETIN: EXXONMOBIL CORPORATION 4 (2021), https://www.blackrock.com/corporate/literature/press-release/blk-vote-bulletin-exxon-may-2021.pdf [https://perma.cc/DRT4-VPA5]. The incentives argument was also referenced, though not as explicitly as in Engine No. 1's critique, with Vanguard alluding to "questions about board independence" that it had raised with Exxon for a number of years. VANGUARD GRP., INC., *supra*, at 2. Several investors also commented on Exxon's failure to plan adequately for the energy transition and the long-term value of Exxon. For example, in its statement, BlackRock noted that "Exxon and its Board need to further assess the company's strategy and board expertise against the possibility that demand for fossil fuels may decline rapidly in the coming decades," adding that the company's "current reluctance to do so presents a corporate governance issue that has the potential to undermine the company's long-term financial sustainability." BLACKROCK, *supra*, at 3. Likewise, Vanguard explained that it grounded its "assessment on how any changes to the board's composition would affect [Exxon's] ability to oversee risk and strategy and ultimately lead to outcomes in the best interest of long-term shareholders." VANGUARD GRP., INC., *supra*, at 2.

First, how big is the gap between perfect ESV behavior (that is, fully realizing all opportunities to further stakeholder interests that also benefit shareholders) and actual corporate behavior with respect to various social issues? In some areas it may be that calls for reforms to corporate practices, even though ostensibly based on ESV considerations, are actually better understood as stakeholderist in nature. It may be that public policy is a better tool for responding to those cases than appeals for CSR. But in other areas there may be substantial scope for further improvements to corporate practice on ESV grounds.

Second, what are the main reasons that corporations fail to realize ESV opportunities? Investigating past episodes of reform to corporate conduct might reveal the extent to which such failures stem from lack of information versus incentive conflicts. For example, has recent empirical research documenting the firm value generated by treating workers well[241] led to the spread of such practices in the corporate world? Diagnosing the underlying causes of failure to engage in CSR in ways that benefit shareholders might in turn provide insights into how to intervene in the system to improve corporate performance.

Third, and relatedly, what are the contours of the ESV reform agenda with regard to interventions and corporate governance reforms that might improve CSR in ways that further shareholders' interests? For example, to what extent do governance reforms intended to encourage longer time horizons in management decision-making affect CSR behavior? How can executive compensation arrangements advance ESV considerations? Do popular ESV-oriented interventions—such as enhanced climate disclosures, creating board risk oversight or "sustainability" committees,[242] and appointing independent directors with broader experiences—actually affect CSR decision-making?

Fourth, who exactly are the key actors who might be persuaded by ESV arguments for reform to corporate practices? To what extent are managers, independent directors, and institutional investors persuadable on different ESV issues to act to further such reforms?

241. *See* Edmans, *Does the Stock Market Fully Vale Intangibles?*, *supra* note 62, at 623; Edmans, *The Link Between Job Satisfaction and Firm Value*, *supra* note 62, at 9–11.

242. Lynn S. Paine, *Sustainability in the Boardroom*, HARV. BUS. REV., July–Aug. 2014, at 88; Lisa M. Fairfax, *Board Committee Charters and ESG Accountability*, 12 HARV. BUS. L. REV. 371, 386–95 (2022).

CONCLUSION

At the turn of the twenty-first century, leading commentators announced an "end of history for corporate law," declaring that "[t]here is no longer any serious competitor to the view that corporate law should principally strive to increase long-term shareholder value."[243] Yet the two decades since have witnessed continued developments in corporate law theory and practice that seek to find new pathways for generating more socially responsible corporate behavior. These include new shareholder-centric perspectives that go beyond shareholder value and focus managers instead on more holistic conceptions of shareholder welfare. And even within the traditional paradigm of shareholder wealth maximization, promising innovations abound, including in ways that might improve broader social outcomes. All of these developments suggest to us that the history of corporate law has not yet been fully written, and in this Article, we have tried to assess aspects of this latest chapter. Despite the seeming appeal of conceptualizing shareholder interests in broader terms, on closer examination shareholder welfarism offers little hope for improved corporate conduct. Rather, for those seeking to promote corporate social responsibility, the way forward is through a more thoroughgoing, dare we say enlightened, pursuit of shareholder value.

243. Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 439 (2000).