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Framing a Purpose for Corporate Law

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INTRODUCTION

This Essay seeks to frame a short statement of purpose for corporate law on which all reasonable observers can agree. The statement, in order to succeed at its intended purpose, must satisfy two strict conditions: first, it must have enough content to be meaningful; second, it must be completely uncontroversial, both descriptively and normatively. The exercise, thus described, involves avoiding the issues that occupy center stage in discussions about corporate law while at the same time highlighting the discussants' generally held presuppositions.

A question arises at the outset: why not just remit the matter to economic theory, which suggests a quick resolution in the form of a maximization instruction? Presumably, all reasonable observers will agree that corporate law is a function in an optimization endeavor that seeks to maximize a utility conceived either as wealth or welfare. While the suggestion seems sensible, it still raises a problem. Even if we are certain that all reasonable observers will sign onto a formulation built around wealth maximization, we still would need to uncouple the maximization statement from its context of origin in economic theory and resituate and reconsider it for statement as a legal precept. There is no reason to suppose a seamless process of transition and every reason to undertake a close inspection of any points of cross-disciplinary friction.

Consider in this regard the best known legal statement of the purpose of the corporation (as opposed to purpose of corporate law), the statement contained in section 2.01(a) of the American Law Institute's *Principles of Corporate Governance*: "a corporation . . . should have as its objective the conduct of business activities with a view

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to enhancing corporate profit and shareholder gain."[1] The ALI statement proceeds with notable caution as regards economic concepts. Indeed, it manages to bestow a wealth productive purpose on the corporation without a reference, direct or indirect, to economic theory. The ALI drafter uses the word "enhancing" in place of the economists' word "maximizing" and invokes neither the concept of efficiency nor the concept of social welfare in stating the corporation's economic goal. These omissions are pointed in an era in which terms like maximization, efficiency, and optimality are ubiquitous in policy discussions, implying an unspoken qualification or objection to the standard economic instruction on the part of the ALI drafter. Moreover, the ALI's stated economic goal is bifurcated, divided into corporate profit and shareholder gain, mentioned separately but in conjunction. This strongly implies a preference against shareholder value as an exclusive goal, simultaneously maintaining normative distance from economic theory more generally.

There follow three issues for the present exercise. First, whether the statement of the purpose of corporate law should speak in the stronger terms of maximization and economic efficiency rather than settle for the less demanding notion of "enhancement." Second, whether the statement of purpose should be tied to the shareholder interest, or, to restate the issue in more familiar terms, whether the shareholder primacy principle should be incorporated into the statement of corporate law's purpose. Third, whether the utility to be maximized should (or may) be framed as social welfare. We will see that the three issues are closely interconnected.

Part I states some basic assumptions. Part II takes up the question regarding maximization and efficiency in the statement of legal purpose. Part III considers the appropriateness of designating shareholder value maximization as a singular goal for corporate law. Part IV considers and rejects the inclusion of social welfare as the end in view. The inquiry at this point yields a notably minimal statement of purpose, containing neither a maximization, nor shareholder primacy, nor a social welfare directive. Part V fleshes out the statement by reference not to economic theory but to the inherited structure of corporate law.

I. PARAMETERS

The assignment is to state the purpose of corporate law subject to a constraint of descriptive accuracy. It accordingly needs a start point grounded in basic factual assumptions respecting the law on the ground. Two simple, positive observations should provide grounding sufficient for the task. First, corporate law is about creating wealth. This follows from a basic fact respecting corporate operations—business corporations exist to create wealth by producing goods and services at a profit in capitalist economies. There would be no reason to put up with them if they *didn't* thus succeed as profitable economic producers. Indeed, real world companies that fail to do so disappear in the long run. Second, corporate law addresses a limited set of matters concerning business organizations—it only provides a template for their organization and channels their on-going governance.

These home truths about production for profit and corporate law's role in the wider world of productive enterprise imply parameters for a statement of corporate law's purpose.

1. PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 2.01 (1994) [hereinafter ALI Principles].

The statement must begin with a statement of the purpose of the corporation itself. Since corporate law's job is to set up corporations and regulate their governance, corporate law's objectives must draw on and follow from those of the enterprises it encases. At the same time, the statement of corporate law's purpose must distinguish the function played by the law from the function played by corporate entities. Strictly speaking, corporate law does not produce anything; the enterprises themselves do that. The law's role is secondary and facilitative.

We can put these points together to yield a minimal statement of purpose: corporations exist to create wealth by producing goods and services; corporate *law* is there to help them.

These positive observations imply some conceptual, even philosophical boundaries on the analytical process pursuant to which we more fully articulate the statement. Corporate law assumes production for profit and accordingly occupies a relatively narrow range of economic, political, and ethical territory. It does not purport to influence fundamental political, economic or moral choices. It instead follows from them. By hypothesis, the same goes for any legal theory abstracted from corporate law or brought to bear thereon: it cannot aspire to be all-encompassing. More particularly, corporate legal theory occupies a zone that makes all discussants welfare consequentialists who keep their eyes on productivity. Whatever the discussants' economic, political, or ethical predispositions in other, broader frames of reference, in corporate law their evaluations always center on economic results. The determinative consequence above all other consequences is economic success, usually measured in financial terms. It is determinative because legitimacy for both corporations and the law that governs them follows from success at wealth creation.

II. MAXIMIZATION AND EFFICIENCY

Having specified welfare consequentialism as a theoretical framework, it would seem natural to cast a lot with economic theory and frame the statement of purpose in terms of maximization. But so doing has normative implications, which need to be specified. One of economic theory's base points—the first fundamental theorem of welfare economics—provides a useful point of reference at this juncture.

The first fundamental theorem follows from a general equilibrium model of the economy. All individuals and firms are price takers, each firm produces so as to maximize its profits subject to a production constraint, and each individual consumes so as to maximize individual utility.[2] Externalities are assumed away.[3] Based on these assumptions, the theorem poses that a competitive equilibrium is good for the economy because it maximizes wealth.[4] The normative implication is that whatever can be done to make the economy competitive should be done. If possible, improvements to the functioning of the markets should be made—information asymmetries should be remedied and barriers to competition should be removed. Doing so moves the economy to a production-possibility frontier—the set of Pareto optimal points at which there can be no

2. *See* Allan M. Feldman, *Welfare Economics*, *in* THE NEW PALGRAVE DICTIONARY OF ECONOMICS 722 (Steven N. Durlauf & Lawrence E. Blume eds., 2d ed. 2008).

3. *Id.* at 723.

4. *Id.*

more of A without having less of B. For a given corporate producer, a situation is Pareto optimal if no alternative corporate policy would result in the production of more output (or a need for less of some input).[5] Note that efficiency and output maximization—the most for the least—are the same thing in this context.

It's quite easy to extend the first fundamental theorem to corporate production and, indeed, to corporate law. To wit: a system of corporate production, corporate governance, or corporate law is ex ante efficient if it generates the highest possible payoff for all the parties involved: shareholders, creditors, employees, clients and customers, tax authorities, and other third parties that may be affected by the corporation's actions.[6] Interestingly, the extension is completely uncontroversial,[7] even though it sweeps in all corporate constituents and does not single out the shareholders. That's because the efficient condition it poses is heroic—if everyone is maximizing, no one has any ground to complain, and there is no issue as between the interests of shareholders and other constituents.

Although an uncontroversial corporate maximization instruction is thus easily stated, the transition from economic theory to legal practice remains a problem. An economist, once equipped with the statement as an objective function, can proceed to *model* the problem of getting from a stated here to an efficient there. That, in effect, is his or her job. But no such models obtain in the real world of going concerns, where no one really knows when wealth is being maximized. Moreover, even if someone derived a plausible maximizing template for a given producing context, corporate law would make no attempt to impose it.

A legal mandate to maximize makes no sense in a dynamic economy. Law embeds and constrains where economic actors need space to react and adjust. We can still find an appropriate place for maximization in a statement of corporate law's purpose by distinguishing the corporation's purpose from that of corporate law and referencing corporate law's secondary, facilitative role. That is, corporate law should facilitate the corporation's *attempt* to maximize the value it produces.

The inclusion of a maximization instruction at this secondary level is unavoidable in the context of a competitive economy. Corporate law has no choice in the matter if it is to succeed at its mission of facilitation. To see why, all one has to do is depict a company at the competitive margin, where, if it fails to maximize, it ceases to exist. Corporate law must facilitate that company's attempt to compete and therefore to maximize; it cannot get in the way. Thus does basic economics come down as a hard parameter in corporate legal theory—no assertion about law or policy that fails to recognize and work with it registers in this field.

But there's still a problem, a problem highlighted in the first fundamental theorem. The theorem ties efficiency to competition and implies that we should do everything we can to make the economy more competitive. At the same time, both the theorem and the

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5. *Id.* at 722–23.

6. Marco Becht et al., *Corporate Governance and Control* 15 (Nat'l Bureau of Econ. Research, Working Paper No. 9371, 2002), *available at* http://www.nber.org/papers/w9371.pdf. The text states one of two parts. The second part incorporates the preferences of the affected parties and holds that a system is Pareto optimal if no alternative system exists that all parties prefer. *Id.*

7. *See, e.g.*, Jill E. Fisch, *Measuring Efficiency in Corporate Law: The Role of Shareholder Primacy*, 31 J. CORP. L. 637 (2006); Ronald J. Gilson & Reinier Kraakman, *Clark's Treatise on Corporate Law: Filling Manning's Empty Towers*, 31 J. CORP. L. 599, 602 (2006).

corporate extension posited above assume away externalities. Now that we are situating a maximization instruction in the real world we are no longer at liberty to assume conditions conducive to maximum competition or to assume away externalities. A maximization instruction, directed to a particular real world enterprise (as opposed to the economy as a whole) leads to trouble on both fronts. In the real world, maximizing the value produced inside a given corporation implies externalization of the costs incurred to actors situated on the outside. Real world corporations, moreover, can maximize their own profits by making anti-competitive agreements among themselves. It follows that a maximization instruction, directly applied to individual companies, implies subversion of the first theorem of welfare economics.

Clearly, an adjustment must be made. The question is how to conceive and phrase it. It makes little sense to bid real world corporations to maximize without externalizing, for the lines between internal and external and competitive and anti-competitive are not at all clear. Just as there is no real world template identifying a maximizing production result, so do we lack a template that identifies and minimizes externalities. We can ameliorate the specification problem by making a standard law and economics move, stepping back from Pareto optimality and substituting a Kaldor-Hicks conception. Under this, we would caution that corporate maximization should occur *net* of externalities. This treats externalities like costs, bidding their minimization. But the real world transition remains bumpy, since the directive leaves the nature and impact points of corporate externalities within the maximizing corporations' discretion. Given real world competitive and anticompetitive pressures and regulatory slack, this puts a legal imprimatur on injurious conduct.

The specification problems are solvable only by following the earlier move to a secondary, facilitative role and moving to a higher level of generality. We could mention injury minimization as an aspiration and take care to include a general reference to "wealth" creation in place of a narrower reference to corporation-specific "value" creation and avoid mention of the operative notion of optimality. Thus, corporate law should facilitate the corporation's attempt to maximize the wealth it produces at a minimum external cost.

In the alternative, we can take another look at the ALI *Principles*, whose drafter attempts to dispose of the externality problem in two moves. The first is bound up in the words "with a view to" in the phrase "with a view to enhancing corporate profit and shareholder gain."[8] If we substitute "maximizing" for "enhancing" we bring the ALI statement into better alignment with economic theory and at the same time step back from the negative results bound up in a company-specific maximization instruction: a corporation should have as its objective the conduct of business activities with a view to maximizing the value (or wealth) produced. The ALI *Principles* go on to ameliorate the lack of specificity with a second move in the form of an exception. Under this, a corporation is "obliged to the same extent as a natural person to act within the boundaries set by law."[9] Any legally constituted regulation is thereby swept in as a constraint on the corporate conduct sanctioned by the legally stated objective. Of course, any injurious conduct not prohibited by law is left out, presumably to be picked up by the filter implicit in the "with a view to" phrasing. The ALI solution is imperfect but plausible.

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8. ALI Principles, *supra* note 1, § 2.01(a).
9. *Id.* § 2.01(b)(1).

By way of one or another adjustment, then, a maximization instruction can be worked into a statement of corporate law's purpose without inviting perverse effects. Meanwhile, the exercise teaches an important lesson. Corporate law cannot in theory devote itself to economic maximization without also acknowledging that some authority must mediate relationships, indeed, regulate relationships, between the actors within and without the corporation. Even as corporate law operates within a narrow sphere, it cannot itself foreclose questions respecting corporate relations with society and its own appropriate role in integrating firms within society, at least so long as the proponent of regulation takes care to recognize and interrogate the firm's economic objective.

III. SHAREHOLDER PRIMACY

Recall that in a corporate restatement of the first theorem of welfare economics, efficiency means generating the highest possible payoff for all the parties involved: shareholders, creditors, employees, tax authorities, and other third parties that may be affected by the corporation's actions.[10] This all-encompassing maximization statement triggers two questions in the context of today's corporate law debates. First, what analytical sequence takes us from this uncontroversial and constituent-inclusive statement to shareholder primacy? And second, given that analysis, should shareholder value maximization be inserted into the statement of corporate law's purpose?

Several assumption-laden steps separate all-inclusive optimality from shareholder primacy. The first step was taken by Jensen and Meckling in their famous exposition of a microeconomic theory of the firm. They posited that if we model the firm as a nexus of *complete* contracts among all parties involved while modeling the contract between a firm and its shareholders as *incomplete* (in that the shareholders claim the residual return after all other contractual claims have been met), then maximization of shareholder value is tantamount to the economically efficient result.[11] The assertion is literally true—if everybody other than one incomplete contract holder has a complete maximizing contract, then everybody other than the one incomplete contract holder has an optimal return and maximizing for the remaining claimant is economically efficient by definition. The result depends entirely on the contract's operative model that connects the various constituents to the corporation. Its plausibility accordingly depends on the robustness of the model's assumption respecting the completeness of other constituents' contracts.

Shareholder value proponents make a two-part case in favor of the assumption's robustness. The first part is a claim for shareholder entitlement in a world of incomplete contracts. In fact, no one argues that in the real world all other stakeholders enter into complete, maximizing contracts. But it is argued that, relatively speaking, the shareholders' contract holds out less in the way of protection than do the other constituents' contracts.[12] For example, employees can look to alternative employment at their opportunity wage in competitive labor markets, and creditors can take security, draft business covenants, or

10. *See supra* text accompanying note 6.

11. *See* Becht et al., *supra* note 6, at 15–16. Agency costs are assumed away. *Id.*

12. *See* Oliver Williamson, *Corporate Governance*, 93 YALE L.J. 1197, 1210–11 (1984) ("Stockholders as a group bear a unique relation to the firm. They are the only voluntary constituency whose relation with the corporation does not come up for periodic renewal.").

shorten their maturities. In contrast, the shareholders' capital is locked in for an indefinite duration with governance arrangements providing their only further protection. The diagnosis of relative vulnerability leads directly to a claim for shareholder primacy in the statement of the corporation's purpose.[13]

The second part of the shareholder case references alternatives to a shareholder maximization directive and finds them wanting. The argument proceeds in two phases. It is first asserted that decision making costs should be minimized.[14] This in turn implies a limitation on the number of constituents referenced in the statement of corporate objective.[15] Multi-constituent models, it is said, invite incoherence due to conflict among the interests referenced.[16] Incoherence in turn expands the scope of management discretion, potentially increasing management agency costs. Second, the shareholders are the best reference point among the available constituents. As they hold the residual claim, managing in their interest maximizes returns for the corporation as a whole.[17] Their capital investment[18] in the residual lends them an undiluted, pure financial incentive to maximize the firm's value.[19] From an incentive point of view, shareholders contrast favorably against managers and independent directors, whose incentives are compromised by interests in compensation and job retention.[20] The shareholders also contrast favorably against other constituents, whose contractual interests exclude the residual upside.

Both parts of the shareholder case, but particularly the latter part, rest on strong points. But the points also are contestable. Indeed, Jensen and Meckling's shareholder optimality statement leaves open a wide theoretical door for proponents of constituency interests, bidding them to make efficiency arguments from the point of contractual incompleteness.[21] For example, the constituency proponent holds out the contracting process between labor and management and identifies infirmities therein that prevent employee maximization. In addition, given contractual incompleteness and conflicts of interest among different constituent groups, management decisions under a shareholder-maximization instruction can be shown to reduce a corporation's value. For example, shareholder centrism could lead to suboptimal decisions respecting labor relations or actions against creditor interests that trigger an overall increase in the cost of capital.

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13. In Williamson's model, the shareholders are the constituency deserving of board representation. *See id.* at 1227–28. The inclusion of shareholders in the statement of purpose is a further analytical step, but a short one that many make. *See, e.g.*, Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 441 (2001) ("[T]here is today a broad normative consensus that shareholders alone are the parties to whom corporate managers should be accountable, resulting from widespread disenchantment with a privileged role for managers, employees, or the state in corporate affairs.").

14. *See* Becht et al., *supra* note 6, at 16.

15. *See id.*

16. *See* Michael C. Jensen, *Value Maximization, Stakeholder Theory, and the Corporate Objective Function*, 14 J. APPLIED CORP. FIN. 8, 9, 13 (2001).

17. *See, e.g.*, Hansmann & Kraakman, *supra* note 13, at 449.

18. Bengt Holmstrom & Steven N. Kaplan, *Corporate Governance and Merger Activity in the United States: Making Sense of the 1980s and 1990s*, 15 J. ECON. PERSP. 121, 138 (2001).

19. Hansmann & Kraakman, *supra* note 13, at 449.

20. William W. Bratton & Michael L. Wachter, *The Case Against Shareholder Empowerment*, 158 U. PA. L. REV. 653, 666 (2010).

21. *See, e.g.*, Brett H. McDonnell, *Employee Primacy, or Economics Meets Civic Republicanism at Work*, 13 STAN. J.L. BUS. & FIN. 334, 349–50 (2008).

Accordingly, the result for the present exercise is clear. There is no place for shareholder primacy in a statement of the corporate purpose that aspires to general acceptance. The shareholder maximization norm follows from a particular conception of the optimal incentive alignment within the firm, a conception contestable in theory. Nor has it ever dictated the law's terms, even as it has had its moments of influence. It's a debate point, rather than a point of general agreement.

IV. SOCIAL WELFARE

Now to the third question arising in the process of transposing an economic maximization mandate to the legal context: whether the utility to be maximized should (or may) be framed as social welfare.

To answer the question we return to basic economics. The first fundamental theorem, described above, makes no assertion respecting the distribution of the wealth created at the production-possibility frontier.[22] It looks only to economic efficiency—the creation of aggregate wealth. For social welfare we must make reference to the second fundamental theorem of welfare economics. This proposition poses a heroic optimum: once the economy has reached the production-possibility frontier, optimal social welfare can be achieved through appropriate lump-sum taxes and transfers[23] with wealth-redistributive effects. There's a catch, however, because a tax-and-transfer regime that impairs productive incentives is suboptimal and arguably "inappropriate."[24] It follows that optimal redistributive results are unattainable as a theoretical proposition and second best is the best we are going to get. Happily, there is a theory of the second best that comes to bear at this point. This poses that a costly tax-and-transfer regime can conceivably enhance social welfare utility in the context of an economy producing below the production-possibility frontier and so be deemed the preferable outcome precisely because it satisfies preferences for redistribution of wealth across society.[25]

Social welfare, then, is about distribution and is analytically separate from economic efficiency, which is about reaching the efficient production-possibility frontier. It does not take much reflection to see that social welfare maximization has no place in a statement of corporate law's purpose, at least not in a competitive capitalist economy.[26]

The question instead is whether the statement of corporate law's purpose should exclude social welfare concerns entirely—whether all decisions should be made with a view to the shareholders' pocketbooks (or perhaps other constituents' pocketbooks) or whether corporate managers instead may take into account social, charitable or ethical

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22. Feldman, *supra* note 2, at 723.

23. More particularly, given the outcome of the first theorem, almost any Pareto optimal equilibrium can be achieved given imposition of appropriate taxes and transfers. *Id.* at 724.

24. The same point can be restated so that economic equality is achieved: if one manipulates the initial allocation of goods and income with lump sum transfers, then the ex post workings of perfect markets can lead to an equal allocation of wealth. *See* Gillian K. Hadfield, *Feminism, Fairness, and Welfare: An Invitation to Feminist Law and Economics*, 1 ANN. REV. L. & SOC. SCI. 285, 289 (2005).

25. *See* Richard G. Lipsey & Kelvin Lancaster, *The General Theory of the Second Best*, 24 REV. ECON. STUD. 11 (1956).

26. Note that the result can easily be different in a political economy characterized by extensive state coordination of productive resources.

considerations. This question was first heavily debated in the *Harvard Law Review* between Adolf Berle and E. Merrick Dodd in 1932,[27] with Berle arguing that a shareholder value objective was necessary as the means to the end of keeping management power in check,[28] and Dodd arguing that the national economic emergency justified an expanded view of corporate purpose.[29] Since then, corporate law has come to acknowledge the legitimacy of welfare-driven actions in the form of charitable contributions and ethical decision making.[30] But the exception is limited, and heated debates continue, as shareholder primacy advocates square off against constituency and social responsibility proponents.

A question arises at this point: if social welfare is about redistribution of wealth, why do many shareholder primacy proponents equate managing to maximize shareholder value with social welfare maximization, or, in the alternative, assert that shareholder value maximization proxies for social welfare maximization?[31] They are being theoretically incorrect either way—to equate shareholder value maximization with social welfare maximization is to take an economic efficiency analysis out of its appropriate theoretical confines. Worse, the move is insidious. A routinized association between shareholder maximization with social welfare impacts on base-line presumptions in a follow up discussion about corporate law's political economic implications. The "social welfare" characterization imports legitimacy to deregulatory claims. Indeed, when the economic efficiency as social welfare assertion goes unchallenged, redistributive discussion is pretermitted altogether.

V. EXPANSION

The foregoing yields the following statement of purpose: all reasonable observers will agree that corporate law should facilitate corporate attempts to maximize productive output (and hence wealth) in a competitive economy, subject to exterior regulations that control

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27. *See* E. Merrick Dodd, *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145 (1932); Adolf A. Berle, *For Whom Corporate Managers Are Trustees: A Note In Harvard Law Review*, 45 HARV. L. REV. 1142 (1932). The problem with multi-constituent models was the primary point made by Berle in attacking Dodd's introduction of the public interest as a separate concern. The irony of Berle's position was that Berle himself shortly thereafter introduced his own multi-constituent model suffering from the identical problem. *See* William W. Bratton & Michael L. Wachter, *Shareholder Primacy's Corporatist Origins: Adolf Berle and The Modern Corporation*, 34 J. CORP. L. 99, 111 (2008).

28. Berle, *supra* note 27, at 1367, 1370.

29. Dodd, *supra* note 27, at 1148.

30. *See* ALI Principles, *supra* note 1, § 2.01(b)(2), (3) ("Even if corporate profit and shareholder gain are not thereby enhanced, the corporation . . . [m]ay take into account ethical considerations . . . and . . . [m]ay devote a reasonable amount of resources to public welfare.").

31. The base citation is Hansmann & Kraakman, *supra* note 13, at 441–42. The association runs deep. Empirical studies tend to equate share value maximization with social welfare. *See, e.g.*, Jonathan Klick & Robert H. Sitkoff, *Agency Costs, Charitable Trusts, and Corporate Control: Evidence from Hershey's Kiss Off*, 108 COLUM. L. REV. 749, 759 (2008). For criticism of the practice, see Fisch, *supra* note 7, at 640–46. Some observers approach the connection of the two with commendable caution. *See* Jeffrey N. Gordon, *Institutions as Relational Investors: A New Look at Cumulative Voting*, 94 COLUM. L. REV. 124, 125 & 125 n.2 (1994) (stating that social welfare maximization is "not necessarily inconsistent with shareholder wealth maximization"); *see also* Michael Abramowicz, *Speeding Up the Crawl to the Top*, 20 YALE J. REG. 139, 145–46 (2003) (explaining the meaning of proxy status).

externalities. It is purported that the statement is descriptively accurate and that all reasonable observers will agree with it even as many observers might prefer a more extended and particular statement. Neither shareholder primacy nor social welfare made it into the statement, the former being relegated to controversial status and the latter being substantively inappropriate.

Unfortunately, the above, while uncontroversial, does not go very far toward the goal of articulating a meaningful statement of corporate law's purpose, despite effecting the transition of the maximization norm from economic to legal theory. The statement accordingly needs some fleshing out. This Part undertakes this assignment by discontinuing reference to economic theory and substituting reference to the inherited doctrinal context of corporate law, a context that has evolved as corporate law has historically pursued the objective of facilitating production.

Some caveats must be entered. Drawing on an inherited context to add to the statement of the end in view is a risky business, theoretically speaking. A regulatory framework cannot by virtue of its own long past and present existence establish its own legitimacy. It takes a theory to do that. Nor does evolution in history under competitive conditions guarantee a single, first-best contextual outcome. Comparative corporate governance teaches that there are many possible legal frameworks within which actors can competitively produce a widget or construct and operate a communications network.[32] Nor can one assert that an inherited regulatory context controls by right, for at a theoretical level everything remains contestable even if the doctrinal context tends toward stasis. Reference to corporate law doctrine accordingly is made on the descriptive rather than on the normative side of the line.

Corporate law is famous for being an enabling regime. But, in fact, it is built on four mandates. The first two mandates assure management a wide zone of freedom of action respecting production, management, and financial policy. To wit, corporate law grants management absolute control over investment and financial decisions,[33] and agenda control respecting both the terms of the corporate contract and end period decisions like mergers.[34] Beyond those two mandates lie two further mandates—mandates addressed to agency cost reduction: the fiduciary duty of loyalty[35] and an ironclad requirement that the shareholders elect the board.[36] Corporate law emerges as a largely enabling regime only after laying this mandatory groundwork. The framework, established in New Jersey in 1888,[37] changed little during the twentieth century. Subsequent legal innovation centered primarily on the capital markets and the securities laws. There the purpose was the assurance of liquidity, a means to the end of the lowest possible cost of capital in a system characterized by widespread holding of securities.

The doctrinal template suggests a more particular statement of the general purpose of

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32. *See, e.g.*, Becht et al., *supra* note 6, at 58 ("It is not possible to conclude on the basis of economic analysis alone that there is a unique set of optimal rules that are universally applicable to all corporations and economies, just as there is no single political constitution that is universally best for all nations.").

33. *See* DEL. CODE ANN. tit. 8, § 141(a) (2009).

34. *Id.* §§ 242(b)(1), 251(b).

35. *Id.* §§ 102(b)(7), 144.

36. *Id.* §§ 102(A)(4), 141(k), 151(a), 211(b).

37. *See* Harold W. Stoke, *Economic Influence on the Corporation Laws of New Jersey*, 38 J. POL. ECON. 551, 570–71 (1930).

encouraging wealth creation. It can be broken down into two primary components, each of which implies a regulatory corollary, one pair situated on the asset side of the balance sheet and the other on the liability side. On the asset side, it is corporate law's job to encourage long term investment and the risk-taking implicated therein. The corollary is that the law should facilitate a delegation of decision making authority from the providers of capital to the expert managers who deploy it. (The corollary extends over to the liability side of the balance sheet to include substantial management discretion over financing.) On the liability side, it is corporate law's job to facilitate investment in producing assets at the lowest cost of capital. At least one corollary again is implied—the law should secure the presence of liquid trading markets in corporate securities. The other two mandates serve as backstops to protect the assets on the balance sheet's left side—fiduciary duty guards against opportunism and shareholder voting allows intervention in case of poor performance. Both also thereby serve the end of minimizing the cost of capital.

Objections can be predicted as regards the asset side assertions. A proponent of shareholder empowerment will protest the focus on long-term investment and the delegation of decision making authority to management on the ground that what purports to be descriptive embellishment serves to smuggle in the author's normative preference for the managerialist status quo. In fact, the author does prefer the managerialist status quo,[38] but is not thumping that normative tub here. Lowest cost production presupposes long-term investment and long-term investment needs a secure framework—it cannot be achieved based on short-term financing. Indeed, the corporate form's proliferation and success across all developed national economies over a couple of centuries can be attributed to its ability to shield assets from disruptive creditor intervention.[39] Just as long-term investment needs a shield against the creditors of the corporation's stockholders, so does it also need a stable institutional environment and a low-cost decision making structure.[40] Corporate law's hard-wired delegation of decision making authority assures this. While it certainly is true that a hardcore shareholder empowerment advocate would cut back on the delegation,[41] it is hard to imagine that any such partisan would reverse it entirely and turn public company business decision making over to the shareholders. Finally, it should be noted that liability side corollary encompasses and protects short-term equity interests, which come into existence only in reliance on the ready exit door provided by liquid trading markets.

CONCLUSION

We set out to frame an accurate and uncontroversial statement of purpose for corporate law. Here is the result: corporate law should facilitate corporate attempts to maximize productive output (and hence wealth) in a competitive economy, encouraging long-term investment at the lowest cost of capital, subject to exterior regulations that control externalities. Many would expect a tighter focus on maximization, but feasibility constraints preclude it. A more specific shareholder value objective would be both

38. *See* Bratton & Wachter, *supra* note 20, at 658.

39. *See* Henry Hansmann, Reinier Kraakman & Richard Squire, *Law and the Rise of the Firm*, 119 HARV. L. REV. 1333, 1336 (2006).

40. *See supra* text accompanying note 14.

41. *See* Bratton & Wachter, *supra* note 20, at 669–73.

descriptively inaccurate and controversial. Finally, social welfare enhancement, while desirable, lies outside the limited sphere occupied by corporate law.