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ESG: Moving the Equilibrium or Moving the Goalposts?

Martin Edwards[*]

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* Assistant Professor of Law, The University of Mississippi School of Law, J.D. Duke University, B. Acc'y, The University of Mississippi. The author would like to thank his fellow discussants at the Southeastern Association of Law Schools "ESG Intersections in Business Law" Discussion Group, and especially Professor Colleen Baker for organizing and moderating the Group. The author would also like to thank the editors of the *Louisiana Law Review* for excellent editing and thoughtful comments. Any remaining errors are the author's. All my work is dedicated to Annie and Bella.

ABSTRACT

Environmental and social governance (ESG) has been at the forefront of discussions in corporate law theory, doctrine, and practice. Perhaps because of ESG's breadth, there are numerous intersections with existing frameworks, including those of fiduciary duties, securities disclosures, shareholder proposals, shareholder wealth maximization, and so on. This Article evaluates ESG in the context of the *corporate contract*. It focuses on how ESG fits into the current equilibrium of voluntary relationships between and among all the players involved in a corporation. The corporate contract describes all terms of all contracts between and among individuals involved with a given firm: legally enforceable or non-legally enforceable, explicit and implicit, specified and unspecified.

Within the corporate contract, shareholder wealth maximization represents a sort of implicit and not-fully-specified equilibrium norm that may be sketched as follows: directors are to carry out a good faith, reasonably careful process of trying to deliver a return on the shareholders' investment. Fiduciary duties, as well as the market for corporate control and other non-legal enforcement mechanisms, represent backstops against director or manager defection from the norm. But, no such enforcement mechanisms are truly automatic or costless. For this reason, and because the norm is implicit and not fully specified, there has always been space for two eventualities: first, there is the necessary flexibility for directors and managers to take decisive action that results in maximization of the corporate surplus for shareholders—not to mention stakeholders—and second, there is opportunity for some amount of the diversion of the surplus to the directors and managers over and beyond their legally contracted compensation.

To best understand ESG, this Article will explore the life and times of ESG in these terms, and with particular attention to Dean Henry Manne's insights about individual maximizing behavior by managers within corporations. Consequently, this Article proposes that ESG is best understood as corporate directors and managers maximizing their overall compensation from lifetime corporate employment by following the social and personal incentives that the rise of ESG has generated. It does not follow, necessarily, that a legal solution should be forthcoming or that this is an inappropriate or undesirable way to compensate corporate directors and managers, but it does raise questions as to whether and how ESG will contribute to or undermine the long-term equilibrium.

INTRODUCTION

For at least half a decade, environmental and social governance (ESG) has captured the minds of scholars, lawyers, and finance professionals, while winding its way into popular debates.[1] There is a substantial amount of energy behind it, some of it abstract, but some of it quite concrete. For example, various institutions, private and public, develop and publicize metrics or codify rules to implement the broad concepts behind ESG.[2] Major accounting, consulting, and law firms are building practices around ESG, while it seems that just about every corner of the broader business world, including business law circles, are working on something related to

1. An exemplary landmark in the current iteration of the debate was the 2019 Statement of the Business Roundtable, which made an express commitment to principles of corporate governance that elevated non-shareholder stakeholders and environmental sustainability while de-emphasizing shareholder primacy. *Business Roundtable Redefines the Purpose of a Corporation to Promote 'An Economy That Serves All Americans'*, BUS. ROUNDTABLE (Aug. 19, 2019), https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans [https://perma.cc/A7G2-N5JK]. *See generally* Amanda M. Rose, *A Response to Calls for SEC-Mandated ESG Disclosure*, 98 WASH. U. L. REV. 1821, 1822 (2021) (describing the "dizzyingly broad array" of ESG topics). Arguably, ESG is the latest iteration of a much older debate. *See* George Mocsary, *Freedom of Corporate Purpose*, 2016 B.Y.U. L. REV. 1320, 1320 n.1 (2016). *See generally* C.A. Harwell Wells, *The Cycles of Corporate Social Responsibility: An Historical Retrospective for the Twenty-first Century*, 51 KAN. L. REV. 77 (2002).

2. *See* DAVID F. LARCKER ET AL., ESG RATINGS: A COMPASS WITHOUT DIRECTION 2–3 (2022) (describing institutions that score businesses on ESG metrics). *See also infra* Part II.B.

ESG.[3] Notwithstanding Blackrock Chief Executive Officer Larry Fink's recent statement that he would no longer use the term ESG and that some iteration of ESG has existed since the days of "corporate social responsibility," the current emphasis on ESG is likely to persist for the foreseeable future.[4]

Corporate directors and managers are responding to the rise of ESG by making commitments—some more credible than others—to implement ESG concepts into their work.[5] Some commentators are pleased by this development, while others have raised concerns that increasing the focus on ESG will undermine the wealth-creating engine of capitalism.[6] Some commentators have also raised questions about whether ESG is a component of ordinary cost-benefit, financial valuation, or risk analysis, whether it represents a true transfer of surplus to non-shareholder constituencies, or whether it is manifesting as an agency cost where high-level managers place their individual preferences above the profitability of the corporation.[7] The latter view echoes, in part, the ideas of Dean Henry Manne, who in several works expounded upon key alternative margins in the customary agency cost analysis of corporate law and governance.[8] Dean Manne several times observed that *compensation* of managers meant more than just the dollar value of their salaries and benefits.[9] This supported his exemplary observation that even an ostensibly efficient market for corporate control would leave some space

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3. Unless they are working on blockchain, and some are doing both. *See, e.g.*, Nizan Packin & Sean Stein Smith, *ESG, Crypto, and What Has the IRS Got to Do With It?*, 6 STAN. J. BLOCKCHAIN L. & POL'Y 1 (2023).

4. Isla Bennie, *BlackRock's Fink says he's stopped using 'weaponised' term ESG*, REUTERS (June 26, 2023, 3:19 PM), https://www.reuters.com/business/environment/blackrocks-fink-says-hes-stopped-using-weaponised-term-esg-2023-06-26 [https://perma.cc/G3SJ-YMAM]. *See also supra* note 1.

5. *Business Roundtable*, *supra* note 1. *See also* Larry Fink, *The Power of Capitalism*, BLACKROCK (2022), https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter#:~:text=Stakeholder%20capitalism%20is%20not%20about,is%20the%20power%20of%20capitalism [https://perma.cc/W6YV-FGCN].

6. *See generally* STEPHEN BAINBRIDGE, THE PROFIT MOTIVE (2023).

7. *Compare* Stefan J. Padfield, *Crony Stakeholder Capitalism*, 111 KY. L.J. 441 (2022), *with* Max M. Schanzenbach & Robert H. Sitkoff, *Reconciling Fiduciary Duty and Social Conscience: The Law and Economics of Investing by a Trustee*, 72 STAN. L. REV. 381 (2020).

8. *See generally* Richard A. Epstein, *Henry Manne: A Man to Remember*, 20 INDEP. REV. 127 (2015).

9. *See generally* ARMEN A. ALCHIAN & WILLIAM R. ALLEN, UNIVERSAL ECONOMICS 437 (Jerry L. Jordan ed., 2018); Henry Manne, *Entrepreneurship, Compensation, and the Corporation*, 14 Q. J. AUSTRIAN ECON. 3 (2011).

for managers to divert surplus,[10] and his novel theory that licensing insiders to trade on the material nonpublic information their work arguably generates could be a way to compensate internal entrepreneurship.[11]

This Article analyzes the current state of ESG in the spirit of Dean Manne's work. With apologies to Dean Manne's somewhat pessimistic view of corporate social responsibility,[12] this Article proposes that viewing ESG in terms of individual maximization by corporate managers will provide a better understanding of (1) how ESG is changing the shape of managers' incentives, and (2) what ESG portends for the future of the corporate governance equilibrium of shareholder wealth maximization.

The shareholder wealth maximization norm may be understood as an implicit and underspecified term of the *corporate contract* described as follows: directors and managers are to act with reasonable care and in good faith to maximize the value of the corporation for the benefit of the shareholders.[13] Fiduciary law, market forces, and other non-legal enforcement mechanisms provide the broad contours, but nothing can, with 100% accuracy, hold directors and managers to account for maximizing wealth. In the end, it is a baseline assumption, reflecting a workable equilibrium, that the directors and managers are here to try to generate a return on investors' money.[14] This logic, of course, animates the business judgment rule and underpinned the reasoning in both *Dodge v. Ford*[15] and *eBay Domestic Holdings, Inc. v. Newmark*.[16] But, this economic contracting view of the shareholder wealth maximization norm also informs the way the profit-making business firm is understood.

10. Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110, 117 (1965). *Cf.* Peter T. Leeson, *Logic is a harsh mistress: welfare economics for economists*, 2019 J. INST. ECON. 1, 2–3 (2019).

11. Manne, *supra* note 9, at 3.

12. *See generally* HENRY G. MANNE & HENRY C. WALLACH, THE MODERN CORPORATION AND SOCIAL RESPONSIBILITY (1972).

13. Martin Edwards, *Shareholder Wealth Maximization: A Schelling Point*, 94 ST. JOHN'S L. REV. 671, 691 (2021). Of course, it is somewhat imprecise to describe it as implicit, since both *Dodge v. Ford Motor Co.* and *eBay Domestic Holdings, Inc. v. Newmark* are largely good law. Dodge v. Ford Motor Co., 170 N.W. 668 (Mich. 1919); eBay Domestic Holding, Inc. v. Newmark, 16 A.3d 1 (Del. Ch. 2010). Nonetheless, the teeth of the rule those cases describe suggests a low bar or a backstop—i.e., only where a director or control person explicitly states he or she will actively undermine or avoid profit-making is liability apparently possible. *Dodge*, 170 N.W. 668; *eBay*, 16 A.3d 1.

14. Edwards, *supra* note 13, at 714.

15. *See generally Dodge*, 170 N.W. 668.

16. *See generally eBay*, 16 A.3d 1. *See also* Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 VAND. L. REV. 83 (2004).

Directors and managers simply must have the authority to make hard decisions,[17] and often it would be impossible to disentangle whether those decisions are properly oriented to "optimal" shareholder wealth maximization. Like anything else, it is an equilibrium state that works, not one that is perfect.[18]

In light of this, it is important to explore whether or how ESG might be understood as an iterative tweak to this workable equilibrium. Indeed, scholars have described ESG factors in terms of risk management and as pecuniary factors themselves.[19] Professors Max Schanzenbach and Robert Sitkoff helpfully differentiate *risk-return* ESG from *collateral benefits* ESG.[20] Professor Stefan Padfield provides seven different potential definitions for *stakeholder capitalism*, a term he uses interchangeably with ESG, the first of which he names as "an improved form of calculating [positive net present value investments of capital]."[21] These authors chose these categorizations to helpfully define what might or might not be a breach of fiduciary duty by a trustee or corporate manager, but they are a good reflection of the possibility that ESG factors are simply a different way to reveal and quantify risks that must be addressed in the process of maximizing corporate value.

Conversely, critics of ESG have described it as crony capitalism, a new agency problem, a sacrifice of shareholder value for social goals, or more generally as a politization of a domain thought to be generally politically neutral.[22] This Article expands upon some of this thinking, suggesting that the balance of the incentives corporate managers face is shifting from something like "make a quality product and sell it at fair price" to "do that, but also see if you can also balance a myriad of social trends generated from other institutional sources." Corporate directors and

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17. Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. L. REV. 547, 572–73 (2003).

18. *See generally* R.G. Lipsey & Kelvin Lancaster, *The General Theory of Second Best*, 24 REV. ECON. STUD. 11 (1956).

19. *See, e.g.*, Benjamin P. Edwards, *Florida's Anti-ESG Resolution – Pointless or Blinding*, BUS. L. PROF. BLOG (Aug. 25, 2022), https://lawprofessors.typepad.com/business_law/2022/08/floridas-anti-esg-investment-resolution-pointless-or-blinding.html [https://perma.cc/U7F6-JZM8].

20. Schanzenbach & Sitkoff, *supra* note 7, at 389–90.

21. Padfield, *supra* note 7, at 443.

22. Todd J. Zwycki, *Extending the Culture Wars*, CATO INST. (2021), https://www.cato.org/regulation/fall-2021/extending-culture-wars [https://perma.cc/5W64-H34Q]; Tyler Dove, *In the Teeth of Opposition: Improving Public Company Auditing Standards in the United States*, 25 TENN. J. BUS. L. 93, 109–17 (2023) (discussing politization of audit process via political turnover at the Public Company Accounting Oversight Board).

managers, in maximizing their overall compensation from lifetime corporate employment, must and do respond not only to the financial incentives that may also deliver shareholder, and stakeholder, wealth, but also to social or personal incentives.[23] Though it will be difficult to know for sure, it seems likely that the coming years will deliver evidence on the questions of whether ESG can be a part of a workable equilibrium and, if so, whether that equilibrium is superior to the less political and less social equilibrium that came before it.

I. SHAREHOLDER WEALTH MAXIMIZATION AND THE EQUILIBRIUM

Much like the passing of a periodic comet, debates about the proper role of corporations in broader society emerge in an almost cyclical fashion.[24] Unavoidably, the broader political and social debates about corporations and society implicate the economics and legal principles underpinning the formation and operation of corporations. The latest passing of the corporations-and-society celestial orb has, for the moment, come to be known as *environmental and social governance* or *ESG*.[25] Perhaps the impetus for this turn in the debate is the increased cognizance of a warming planet, or, perhaps, the mistrust in economic growth owing from the Financial Crisis of 2008 and the Great Recession, or simply a frustration at the lack of progress on issues intertwined with corporations and society as a whole. In any event, the debate has, in the past half-decade or so, moved to the forefront. This Part will briefly trace the historical debate, in hopes of framing or grounding it in terms of relevant legal, social, and economic principles.

A. A Brief History of Shareholders vs. Stakeholders

The current ESG debate is, at its core, an instance of a long-running tension: how to deal with joint ownership of business assets. Once

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23. *See, e.g.*, W.C. Bunting, *Against Corporate Activism: Examining the Use of Corporate Speech to Promote Corporate Social Responsibility*, 74 OKLA. L. REV. 245, 248 (2022).

24. *See, e.g.*, Martin Duncan et al., *The Origin of Short-Period Comets*, 328 AMER. ASTRONOMICAL J. L69 (1988) (describing periodic comets); Mocsary, *supra* note 1, at 1320 n.1 (collecting citations); Wells, *supra* note 1, at 79 n.9 (citing Stephen M. Bainbridge, *Community and Statism: A Conservative Contractarian Critique of Progressive Corporate Law Scholarship*, 82 CORNELL L. REV. 857, 902–03 (1997)).

25. The most recent orbit before ESG was called *corporate social responsibility*. *See generally* Wells, *supra* note 1, at 78.

property ownership is joint rather than singular, conflicts of interest, imperfect incentives, and surplus distribution problems, among other matters, must be confronted. Many familiar legal rules and norms emerged to deal with these tensions. There are two somewhat disjunctive historical narratives that shape modern thinking about the corporation and corporate purpose: first, the development of the joint-stock company for purposes of exploration of the New World and familial or ecclesiastical financial organizations, sometimes also concerned with sea exploration or banking. The former seems more "public" in nature, while the latter seems more "private." Second, and related to the larger, more formal company, is the longstanding tension between public and private power. At times they seem at odds, while at others they seem more coordinated.[26] Common to these historical narratives is mitigating harm from the potential mismatch in incentives arising from divided ownership of common assets and, where the collections of assets were industrially large, how to manage the corporation's relationship with and effect on the public or society as a whole. Furthermore, commentators regularly debate about whether the legal privileges apparently granted to corporations justify greater intervention in corporate governance to advance policy goals.

1. Collaborative Economic Activity—The Blurry Lines of Public and Private

The modern corporate form developed from joint-stock companies given charters by sovereigns for exploration of the New World.[27] Later, states granted corporate charters to natural monopolies affected with the public interest.[28] Over time, the grant of the corporate charter evolved from a political act by a political body, such as a state legislature, to a ministerial act by an executive officer, such as a Secretary of State. Beginning with the waning years of the 1800s, this evolution culminated in short order with all states granting corporate charters ministerially pursuant to "general incorporation statutes" rather than by legislative action.[29] Distinguished from the emergent partnership form—which grew from small family businesses in Italy in the 1500s—the corporation was clearly

26. *See, e.g.*, William W. Bratton, *The Separation of Corporate Law and Social Welfare*, 74 WASH. & LEE L. REV. 767, 768 (2017) (describing a social settlement that facilitated stable corporate relations with society).

27. DOUGLAS M. BRANSON ET AL., BUSINESS ENTERPRISES: LEGAL STRUCTURES, GOVERNANCE, AND POLICY 6–7 (4th ed. 2020).

28. BRANSON ET AL., *supra* note 27, at 7–8; Henry G. Manne, *Our Two Corporation Systems: Law and Economics*, 53 VA. L. REV. 259, 259–60 (1967).

29. BRANSON ET AL., *supra* note 27, at 9.

a superior structure for larger-scale, more socially impactful economic activity.[30] As a consequence, corporate law norms developed in response to the tension of dispersed ownership and a small number of individuals in control—what might be called the *private-law* aspects of the tension.[31] But, in addition, it involved a relationship between the state and its interests, and this ostensibly private business activity. This history suggests a long-running tension between the public and private nature of business activity.[32] The developing law and norms tended to involve both aspects in some way.

For example, some commentators have suggested that the history of corporate chartering by political act—especially given that these early, politically chartered corporations often served a broader public purpose or provided some public good—implies a greater role for state or social regulation of corporations.[33] At minimum, commentators and public officials have argued that this could at least be true for very large corporations that have a substantial social impact, regardless of whether they in fact have an expressly social or public purpose or supply a public good.[34] In addition to regulating corporations directly, the government

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30. *Id.*

31. *See* Manne, *supra* note 28, at 260–61 (describing the use of the corporate form as a way to raise capital for large, private business activity). *See generally* FRANK EASTERBROOK & DANIEL FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW (1991). For a general description of the difference between public and private law, *see* Randy E. Barnett, *Foreword: Four Senses of the Public Law-Private Law Distinction*, 9 HARV. J. L. PUB. POL'Y 267, 270–71 (1986).

32. *See, e.g.*, Hillary A. Sale, *Public Governance*, 81 GEO. WASH. L. REV. 1012, 1016 (2013) (describing the impact of legal choice on private choices). *See also* Ann M. Lipton, *What We Talk About When We Talk About Shareholder Primacy*, 69 CASE W. RES. L. REV. 863, 867 (2019) (describing the legal choice of shareholder primacy as "imposed" and not necessarily an exclusively "private choice" (alterations omitted)).

33. *See* Charlie Cray & Lee Drutman, *Corporations and the Public Purpose: Restoring the Balance*, 4 SEATTLE J. SOC. JUSTICE 305, 307 (2005) ("If we recognize that corporations are public institutions, created under a process in which ultimate authority is vested in the citizens, then it becomes clear that corporations do not intrinsically bear any rights or privileges except those that citizens choose to confer on them").

34. *See* Benjamin P. Edwards, *A Heavyweight Division in Corporate Governance?*, BUS. L. PROF. BLOG (Oct. 10, 2019), https://lawprofessors.typepad .com/business_law/2019/10/a-heavyweight-division-in-corporate-governance.html [https://perma.cc/J4KJ-7QR3] (describing in general terms the state's prerogative to regulate corporations granted state privileges such as limited liability). *See also*

could impose regulations on internal corporate governance that orient board and management toward political goals.[35]

Moreover, one of the primary animating features of the corporate form is the privilege of limited shareholder liability. This innovation is almost unavoidably owing to the state and legal system. Statutes recognize limited liability, and courts only very rarely disregard the corporate form to hold individual shareholders liable for debts of the corporation. Even then, only shareholders who directly participate in the business and the substantial inequitable conduct that led to the disregard of the form are liable. It is possible, of course, that an approximation of such a system could have emerged or evolved in the absence of a formal state recognition or grant of limited liability.[36] Even so, history and experience suggest that the state establishing limited liability by way of a statutory rule is the lowest-cost mechanism for supplying socially valuable limited liability for corporations.[37] In brief, the social value of limited liability is at least twofold.[38] First, it incentivizes reasonable risk-taking, which is usually expected to result in economic growth and, as a consequence, greater overall social welfare. Second, it incentivizes equity owners to leave their capital invested in the corporation, since personal liability for the debts of the business would incentivize undercapitalization and make it more difficult for creditors to identify and litigate against individual shareholders for their personal assets.[39]

The state-granted version of the privilege of limited liability is, likewise for some commentators, grounds for greater state or social regulation of corporate activity.[40] That is, the state should be permitted to exercise greater control over the purpose and governance decisions within

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Sale, *supra* note 32, at 1032–33 (referring to private ordering as a "privilege . . . subject to erosion" where it may have been "abused").

35. *See, e.g.*, Assem. Bill No. 979, 2023–2024 Reg. Sess. (Cal. 2023) (requiring corporations located in California to meet certain board diversity requirements).

36. Paul G. Mahoney, *Contract or Concession? An Essay on the History of Corporate Law*, 34 GA. L. REV. 873, 877–78 (2000).

37. Stephen M. Bainbridge, *Community and Statism: A Conservative Contractarian Critique of Progressive Corporate Law Scholarship*, 82 CORNELL L. REV. 857, 865 (1997).

38. Judge Frank Easterbrook and Professor Daniel Fischel identify no fewer than six justifications for limited liability. EASTERBROOK & FISCHEL, *supra* note 31, at 41–44.

39. Bainbridge, *supra* note 37, at 865.

40. Mahoney, *supra* note 36, at 876 (describing arguments that limited liability is a state privilege granted for policy reasons, with the implication that the same could be taken away).

corporations as part of the state's granting of the privilege of limited liability. Notwithstanding the more thorough economic explanations and more private-law-like doctrinal development described in Part I.B, there has always been a theoretical, economic, and doctrinal tension surrounding how the law acts upon corporations with respect to their role in society. In sum, at least part of the ESG debate involves the relationship between state power, social goals, and private economic activity. That is, it involves ostensibly public-law aspects of corporate law. Even so, this conversation remains stubbornly situated within conversations about the law and norms of corporate governance—machinery evolved largely to deal with the private-law problem of divided ownership of corporate assets.[41]

*2. Doctrine and Early Doctrinal Scholarship—*Dodge*,* eBay*, and Berle-Dodds*

Dodge v. Ford Motor Co. stands out among the landmark decisions in the corporate law canon.[42] The case pitted the Dodge brothers, minority shareholders of Ford Motor Company, against controlling shareholder Henry Ford.[43] The Dodge brothers challenged Henry Ford's refusal to declare dividends proportionate to a continuously growing surplus.[44] Henry Ford apparently wished to use the surplus to expand the corporation and "spread the benefits of this industrial system to the greatest possible number."[45] Henry Ford's testimony led the Supreme Court of Michigan to characterize his view as expending corporate resources toward "a general purpose and plan to benefit mankind at the expense of others."[46] The Court then propounded the statement for which the case is most cited: "A business corporation is organized and carried on primarily for the profit of the stockholders."[47] While granting, as courts consistently have, that the power to allocate the corporate resources between distributions and retained earnings lies with the board of directors, the Court affirmed the trial court's order requiring distribution of massive sums of earned surplus

41. *See generally* Bratton, *supra* note 26.
42. Dodge v. Ford Motor Co., 170 N.W. 668 (Mich. 1919). *But see* Lynn Stout, *Why We Should Stop Teaching* Dodge v. Ford, 3 VA. L. & BUS. REV. 163 (2008).
43. *Dodge*, 170 N.W. at 669.
44. *Id.* at 683.
45. *Id.* at 671.
46. *Id.* at 684.
47. *Id.*

to shareholders.[48] *Dodge* is cited for several propositions, but perhaps one is that courts of equity also recognize that their role in corporate law stems from private-law concerns.[49] Private law is, naturally, more inclined toward private wealth maximization. It is a short leap to suppose that private wealth maximization is the purpose of any corporation, regardless of size and dispersal of ownership.

However, there are other interpretations of *Dodge*, both on its facts and as a reflection of doctrine. Some alternative interpretations include the argument that the *Dodge* Court's broad language about corporate purpose was in reference to the unique problems of close corporations.[50] Specifically, Dean Gordon Smith argued that *wealth maximization* was not about large-scale corporate activity, but that, instead, it was a judicial approach to resolving majority-minority disputes in close corporations.[51] *Close corporations* are more akin to partnerships, and their problems are more traditionally private law-type issues.[52] Similarly, Professor Lynn Stout argued that, among other reasons to "stop teaching *Dodge v. Ford*," the case was about the relatively more mundane issue of abuse of minority shareholders by a majority controller.[53] Henry Ford's motivations for using his majority position against the minority shareholding Dodge brothers, according to Professor Stout, were not necessarily for the high-sounding, non-wealth-maximizing reasons he proffered.[54] Instead, he desired to prevent them from having the resources to start a competitive car company, and he wished to freeze them out, redeeming their shares at the lowest possible value.[55] The latter technique is a chronic issue in small corporations and, at least viewed through Professor Stout's and Dean Gordon's interpretive lenses, not particularly relevant to the purpose or operation of large business enterprises in light of their impacts on society as a whole.[56] In other words, typical private wealth maximization norms

48. *Id.* at 677 (trial court's order described); *id.* at 685 (affirming).

49. *See generally* D. Gordon Smith, *The Shareholder Primacy Norm*, 23 J. CORP. L. 277, 279 (1998) (framing *Dodge* as a case about disputes among shareholders in closely held corporations, rather than as a broader statement about the public purpose of the corporation).

50. *Id.*

51. *Id.*

52. *See, e.g.*, Donahue v. Rodd Electrotype, Inc., 328 N.E.2d 505 (Mass. 1975).

53. Stout, *supra* note 42, at 167–68.

54. *Id.*

55. *Id.*

56. *Id.* at 168. *See* Smith, *supra* note 49, at 279.

have little answer for social problems generated through large scale corporate activity.

Notably, no Delaware decision would make such a sweeping statement about corporate purpose until roughly 90 years later in *eBay Domestic Holdings, Inc. v. Newmark*.[57] *eBay* involved a dispute between eBay, Inc., which had invested a minority stake in Craigslist, Inc., the operator of the online classifieds website of the same name.[58] While the founders of Craigslist argued that they understood Craigslist to be a business with a "public-service mission," Craigslist was a standard-issue Delaware corporation.[59] That is, it was not designated as a not-for-profit enterprise or a charity. After an intercorporate dispute about the future of the business—eBay wanted to engage in further monetization of the platform, Craigslist's founders Jim Buckmaster and Craig Newmark did not—the founders used a shareholder rights plan to entrench their majority control.[60] Their actions were apparently for the purpose of ensuring that the business eschewed further monetization and retained its character as a public service.[61] The Delaware Court of Chancery rebuked the founders, holding that the fiduciary obligations that come with the for-profit Delaware corporation must include "acting to promote the value of the corporation for the benefit of its stockholders"[62] and concluding that Jim and Craig "specifically, clearly, and admittedly [sought] *not* to maximize the economic value of a for-profit Delaware corporation for the benefit of its stockholders."[63] While no one could call eBay Domestic Holdings, Inc., a small business, one certainly could argue that the true nature of the dispute was about the direction of the business between a small group of owners.[64] A doctrine of wealth maximization may or may not be a perfect solution for all the private-law issues applicable to dispersed shareholders in public corporations, much less the public-law issues that arise.

The first modern academic debate about corporate purpose was not really about corporations and society at all, at least not at first. In fact, it was another example of a debate over how the law should deal with a set of private law concerns—specifically, the possibility of corporate

57. eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1 (Del. Ch. 2010).

58. *Id.* at 6.

59. *Id.* at 32, 34.

60. *Id.* at 16, 21 (there were many other points of contention between the parties, e.g., eBay launching a competitive classifieds website allegedly using proprietary Craigslist information).

61. *Id.* at 32.

62. *Id.* at 34.

63. *Id.*

64. Smith, *supra* note 49, at 277.

managers diverting all the corporate surplus to themselves. In 1931 and 1932, Professor Adolf Berle and Professor Merrick Dodd had a brief, but thoughtful, exchange about the state of corporate law and the rise of large corporations.[65] Professor Berle advised a rigorous doctrine of shareholder primacy, which he viewed as critical in a world where directors had statutory and legal powers that appeared nearly sui generis.[66] Professor Dodd countered that directors' broad legal powers should not be so limited, predicting that the law might be better suited to a view of large corporations as more public institutions than Berle's shareholder focus might permit.[67]

Not long after Professor Dodd presented his rebuttal, Professor Berle, along with co-author and economist Gardiner Means, presented their opus on large corporations with dispersed ownership.[68] In *The Modern Corporation and Private Property*, Professors Berle and Means lamented the lack of serious checks and balances on managers who oversaw and allocated great collections of assets.[69] They began from a traditionally legal premise: that property owners bearing all the burdens and enjoying all the benefits of property ownership was efficient.[70] Then, they contrasted this theory with the massive collections of assets under the control of groups of corporate managers and directors, arguably previewing what would later be known as *agency costs*.[71] Professor Berle's preferred solution, consistent with his thought a year earlier, was a sort of trusteeship where transparency and accountability were approximated through legal and social norms of shareholder primacy.[72] His second-best solution might have been a political and social consensus of corporate statesmanship, where corporate managers, and therefore corporations themselves, were subject to layers of constraints.[73] One of

65. *See generally* Adolf A. Berle, *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049 (1931); E. Merrick Dodd, Jr., *For Whom are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145 (1932).

66. Berle, *supra* note 65, at 1049.

67. Dodd, Jr., *supra* note 65, at 1147–48.

68. *See generally* ADOLF A. BERLE & GARDINER MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1932).

69. *Id.* at 3.

70. *Id.* at 8–9.

71. *Id.*

72. *Id.* at 3.

73. *Id*. at 356.

those constraints would be a muscular state, not unlike the one he himself helped build as part of the New Deal braintrust.[74]

The original Berle-Dodd debate is a bit anachronistic now, given that both parties seemed careful not to make too many predictions about the shape of the law, and within a few years of their first back-and-forth, the two had almost switched sides of the debate in any case.[75] Professor Dodd seemed to have clarified the implications of his view that corporate managers, on their own, could conceivably balance all the interests apparently at the table because of the existence of the large corporation. By the mid-1930s, he had almost reverted back to a shareholder-centric view of corporate purpose instead of the more managerialist position he took in *For Whom are the Corporate Managers Trustees?*[76] By the mid-century, Professor Berle observed that the New Deal had resulted in a corporate and social framework consistent with his second-best solution of a public-opinion-shaped corporate statesmanship, though he did not necessarily abandon his concern for dispersed shareholders.[77]

3. Modern Scholarship—the Mid-Century Social Contract, CSR, Friedman, and Back Again

As Berle observed in the 1960s, everything he worried about when he co-authored *The Modern Corporation and Private Property* never came to pass, largely because corporate managers appeared to take their roles as corporate statesmen seriously.[78] Professor William Bratton, in an article highlighting the work of Professor David Millon, argued that the corporate law of the mid-century was in harmony with the mid-century social settlement of the time—which ostensibly included the strong New Deal state of which Berle was a principal architect.[79] The upshot of Professor Bratton's essay is that corporate law and social responsibility were in harmony through the "equipoise" of social, political, and legal forces.[80] Professor Bratton frames the revolution in corporate law in the 1980s as

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74. Bratton, *supra* note 26, at 768 (citing ADOLF A. BERLE, THE AMERICAN ECONOMIC REPUBLIC 81–82 (1963)). *See also* Adolf A. Berle, *Modern Functions of the Corporate System*, 62 COLUM. L. REV. 433, 433 (1962).

75. Wells, *supra* note 1, at 98. *See also* Bratton, *supra* note 26, at 768 (describing Means's having stood for the "opposite proposition" with regard to public power of corporations).

76. *See* Wells, *supra* note 1, at 98.

77. Berle, *supra* note 74, at 434–35.

78. *Id*. at 433.

79. Bratton, *supra* note 26, at 770.

80. *Id.*

the synthesis of simmering conflict lurking beneath the social and political settlement of the time.[81] Secular social and economic events such as the Vietnam War, oil crisis, stagflation, and the fragmentation of the New Deal political coalition conspired to drive a wedge into the stable, mid-century equilibrium.[82] The practical effect, according to Professor Bratton, was taming the balancing force of the authoritative state.[83] The push and pull between the public-law and private-law nature of the corporation and corporate law has a long history, perpetually animating social and doctrinal debates since the dawn of the large, industrial corporation.[84]

At the same time, economist Milton Friedman was a famous and public face of a movement in economics, and law, to guide economic policy toward relatively more economic freedom and relatively less state intervention.[85] His landmark statement on corporate governance was pithy, if perhaps more complex than is often thought: the responsibility of corporate executives "is to conduct the business in accordance with [the shareholders'] desires, which generally will be to make as much money as possible while conforming to the basic rules of the society, both those embodied in law and those embodied in ethical custom."[86] Perhaps contrariwise to Professor Bratton's description, Friedman viewed the allegedly consensus understanding of the corporation as a part of a broader social compact, rather than as an engine of private economic wealth creation, as suspiciously vague. Indeed, even Friedman's description of the use of the corporate form for eleemosynary purposes is fairly consequentialist—such a corporation exists for providing the service for which its founders chartered it, not necessarily specifically for whatever social good might be attached to its mission.[87] Friedman pronounced his famous doctrine in 1970, and the years that followed would see many of Friedman's and his fellow travelers' nostrums enacted. Many of those prescriptions flowed from economic work done much earlier in the century.

81. *Id.* at 767.
82. *Id.* at 774.
83. *Id.* at 773–74.
84. Wells, *supra* note 1, at 78.
85. *See generally* MILTON FRIEDMAN & ROSE FRIEDMAN, FREE TO CHOOSE: A PERSONAL STATEMENT (1980).
86. 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/M7M5-8PAK].
87. *Id.*

B. The Economic Theory of the Firm

This Part highlights some of the more prominent economic theories of the firm. Economic theories of firms and contracting heavily influenced corporate law during the latter part of the 20th century and into today. It begins with a youthful economist, Ronald Coase, who would later spend the great bulk of his career housed at the University of Chicago Law School, where he would become more famous for his take on externalities[88] than his take on firms.[89] It traces other important works, including those of financial economists on agency costs and team production and, of course, Dean Manne's heavily economic legal scholarship.

1. Coase explains it all.

Economist Ronald Coase arrived in the United States in the 1930s as a socialist.[90] He toured great American factories, looking for empirical evidence of how production worked in the real world. He was somewhat skeptical of contemporary economists' treatment of individuals and firms as atomistic agents in market models. What happened within the firm? Also, why a firm at all? Why not just markets? And if not markets, why not just have state institutions control substantial swaths of the means of production? Coase's answer, though he did not use the term at the time, was what most now refer to as *transactions costs*.[91] In *The Nature of the Firm*, Coase observed that "there is a cost of using the price mechanism."[92] Thus, the size of the firm and the scope of production it would perform was in some way a factor of how relatively costly it was to conduct the firm's activity.[93]

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88. *See generally* R.H. Coase, *The Problem of Social Cost*, 3 J. L. & ECON. 1 (1960).

89. *See generally* R.H. Coase, *The Nature of the Firm*, 4 ECONOMICA 386 (1937).

90. *See, e.g.*, *Ronald Coase on Externalities, the Firm, and the State of Economics*, ECONLIB (May 21, 2012), https://www.econtalk.org/coase-on-externalities-the-firm-and-the-state-of-economics/ [https://perma.cc/82V9-UUX5] (Coase explaining that he was a socialist and describing the thesis of *The Nature of the Firm*).

91. Coase, *supra* note 89, at 390. *See also* Oliver Williamson, *Transaction-Cost Economics: The Governance of Contractual Relations*, 22 J. L. & ECON. 233, 233 n.1 (1979) (attributing the concept of transactions costs to Professor Coase).

92. Coase, *supra* note 89, at 390.

93. *Id.* at 395.

Two major implications for the corporation—the legal form of many economic firms—flow from Coase's primary observations in 1937. First, Coase's explanation of the firm did not require an obvious relationship between the state and the corporation. Contrary to the view of corporations as creatures of the state, Coase's economic theory suggested an explanation for the development and operation of corporations that did not necessarily require the political discretion of state actors for its justification.[94] Second, it set the groundwork for the firm as a related set of contractual relationships. Perhaps Coase's own words did not reflect as contractual a model of the corporation as later models based on his work would describe. As just one example, Coase analogized the entrepreneur within the firm as operating a hierarchy of command and control, an observation economists Armen Alchian and Harold Demsetz would later describe as inaccurate.[95] Later legal scholars and economists would credit Coase's insights as foundational, despite that *The Nature of the Firm* apparently went mostly unnoticed for some years afterward.[96]

2. Jensen & Meckling, Alchian & Demsetz, and who else? Dean Manne

There are several landmark works of economics and finance that came to characterize the theory of the firm following Coase. Among the most notable works is that of Michael Jensen and William Meckling, whose work inspired multiple decades of scholarship and millions of words about *agency costs* in the corporation and the *nexus of contracts* that underpins the contractarian model of the firm.[97] Professors Jensen and Meckling produced a comprehensive theory of the firm steeped in the economic analysis of property rights, agency costs, and economic contracting.[98] The core of Professors Jensen and Meckling's analysis is that the shape of the firm—as opposed to the shape of markets—is a function of the contractual relations and incentives generated by external markets and internal relations.[99] Agency costs generate imperfect solutions to them, which are

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94. *See id. See also* Cray & Drutman, *supra* note 33.

95. Armen Alchian & Harold Demsetz, *Production, Information Costs, and Economic Organization*, 62 AM. ECON. REV. 777, 777 (1972).

96. Oliver Williamson, *Transaction Cost Economics: The Natural Progression*, 100 AM. ECON. REV. 673, 675 (2010).

97. Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 306 (1976).

98. *Id.*

99. *Id.* at 311.

reflected in intricate contractual bonding mechanisms.[100] Viewing the firm, or any other institution, as a nexus of contracts allows various observed features of corporations to be rationalized. Most importantly, Professors Jensen and Meckling proposed that all descriptive roads lead back to *individual maximizing* behavior.[101]

Another phrase that permeates the corporate law discourse is that of *team production*.[102] As economists Armen Alchian and Harold Demsetz described, large organizations of production involve substantial transactions costs in "metering" team members' contributions and monitoring team members to prevent them from shirking the responsibilities associated with their roles.[103] The rise of the corporation and its shape is, to Professors Alchian and Demsetz, a function of the relative costs of maintaining and operating various structures for metering and managing team production and of specifying contracts across markets.[104]

At the same time, Dean Manne was formulating one of his most underappreciated works: *Our Two Corporation Systems: Law & Economics*.[105] Among several of Dean Manne's works pushing back against the Berle & Means thesis, the article argued that centralization of management on the separation of ownership and control was an efficiency, not a cost or risk.[106] At minimum, Dean Manne suggested that among alternatives, none of which are without cost, the corporate structure apparently was the lowest cost way to organize the economic activity large corporations conduct.[107] Furthermore, Dean Manne presented a comprehensive economic analysis, with persistent application of individual maximization within the firm and outside of it. The core of his analysis of the large public corporation was that the large public corporation was not a larger version of a partnership, where entrepreneurs pooled their time, talent, and capital with the understanding that those roles would be ongoing. Instead, the corporation was a device for gathering up capital.[108] The shareholder was not a partner or an entrepreneur, but a

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100. *Id.* at 312–13.

101. *Id.* at 307.

102. *See, e.g.*, Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247 (1999).

103. Alchian & Demsetz, *supra* note 95, at 778.

104. *Id.* at 783.

105. *See generally* Henry G. Manne, *Our Two Corporation Systems: Law & Economics*, 53 VA. L. REV. 259 (1967).

106. *Id.* at 261; Epstein, *supra* note 8.

107. Manne, *supra* note 105, at 260–61.

108. *Id*. at 261.

supplier of capital. Suppliers of capital simply want a return. Managers of large corporations were not also partners, they were providing a special function—management of assets. Of course, this description was not dissimilar from that of Professors Berle and Means, but Dean Manne did not see it as problematic—just another case of economic forces shaping social and later legal norms.[109] Professor Manne's other works, operating within the same framework, are discussed in Part III.

Along with Professor Coase, these exemplary works established the contours of an economic theory of the firm. A remaining question, central to the ESG debate swirling across the legal and political landscape, is what conclusions one should draw from these economic works. The application of the economic description of the firm to the law of the corporation is an ongoing project, which has confronted some barriers. As Professor Stephen Bainbridge once observed, perhaps those who view the firm in a more private-law manner and those who view it in a more public-law manner are simply talking past one another.[110]

3. Easterbrook & Fischel—Putting the "Law" in Law & Economics?

Former Professor and current Judge Frank Easterbrook and his colleague Professor Daniel Fischel authored a series of law review articles, later updated and revised into a book, to synthesize the economics and finance literature with the extant corporate law.[111] Following Coase's and Manne's law and economics methodology, Easterbrook and Fischel's claim was simple: the legal structure of corporate law—a contractual one—reflected the economic incentives facing the corporation, and this was good.[112] Indeed, the spirit of Easterbrook and Fischel's work was the same as the economic and financial literature described above.[113] Where Professors Jensen and Meckling explained observable economic features and financial makeup of corporations in terms of the incentives facing the individuals involved,[114] Judge Easterbrook and Professor Fischel described the development and implementation of corporate law in the same manner.

Specifically, with respect to corporate purpose, Judge Easterbrook and Professor Fischel were of the view that the *default* legal purpose of the corporation was to maximize the financial or economic value of the firm,

109. *Id.*
110. Bainbridge, *supra* note 37, at 860.
111. EASTERBROOK & FISCHEL, *supra* note 31.
112. *Id.* at 15.
113. *See id.* at 355.
114. Jensen & Meckling, *supra* note 97, at 311.

as this was the hypothecated, if not actual, desire of corporate shareholders.[115] The critical feature for Judge Easterbrook and Professor Fischel, not only for corporate purpose but for the entirety of corporate law, was that most rules would be *default* rules.[116] Thus, the question of corporate purpose was not really that important in and of itself. As Dean Manne had also observed, the nub of the matter was not what the purpose of the corporation is or should be at any given time, but what the relevant parties had decided it would be at the outset.[117] The only thing that matters is that there would not be a surprise change midstream. In a manner of speaking, Judge Easterbrook and Professor Fischel had closed the loop on *Dodge v. Ford*. No one really needed to believe that *Dodge v. Ford* had established in a philosophical way the purpose of the corporation, but rather, had simply chastened a majority controller who wanted to change the bargain in midstream. Of course, Judge Easterbrook and Professor Fischel's legal model of the corporation is a private-law one.

C. Shareholder Wealth Maximization as an Equilibrium Condition; Comparing Equilibrium Conditions

Simply because it is unavoidable, and not because he belongs in a section with these luminaries, this Part describes the author's synthesis of these works as it relates to the actual operation of the shareholder wealth maximization norm within the corporate bargain. Consistent with the works described in this Part, the author supposes that the relationship between a corporation's shareholders and its directors and officers is a contractual one.[118] That contractual structure runs on the individual maximizing behavior of all parties to all relevant contracts involved. Shareholder wealth maximization, naturally, should be understood as a term of that contract. Of course, no corporate charter states, "the purpose of this corporation is to maximize its value," and very few binding legal

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115. EASTERBROOK & FISCHEL, *supra* note 31, at 6–7; 21–22; 35–39.

116. *Id.* at 21–22.

117. *Id.* at 36.

118. *Id.* at 15. Despite the use of the terms *contract*, *contractual*, and *contractarian*, the author cautions readers about the limitations of using the term *contract* to describe the corporate bargain. The legal connotations of these words suggest more formality and enforceability than may be descriptively accurate. *See also* Leeson, *supra* note 10, at 2 n.2 (describing the distinction economist Yoram Barzel drew between "legal" and "economic" property rights).

authorities use those words. This leads to the oft-repeated conclusion that shareholder wealth maximization is, at most, a *norm* rather than *law*.[119]

Even if shareholder wealth maximization is a norm rather than binding law, or if it is never found in a corporate charter, it is and must be a tacit term in the corporate bargain. Tacit terms, as opposed to express terms, have the quality of being binding largely by economic forces rather than legal ones. Furthermore, and as is relevant here, they have the qualities of being underspecified and rewriteable. Their precise contours are not and cannot be crystallized. One of the most important, but rarely confronted, concepts in all the economic work on the law of corporations is the true nature of the tacit, unwritten, underspecified aspects of the bargain.[120] Removed from the costly and rigid strictures of the law, these spaces within the relevant bargains represent flexible and adaptable norms that usually gravitate by economic force in a manner uncomfortably analogous to natural selection.[121]

Viewed this way, the shareholder wealth maximization norm reflects a workable equilibrium. It is a tacit understanding that an investor purchases stock with an expectation that he or she is doing so for financial return. The corporation whose stock he or she bought is an investment vehicle for returns in which he or she will share. This does not often have any practical legal significance, primarily because most corporations do spend most of their resources trying to generate a return, with the unavoidable leakage of various transactions costs. Thus, it is a load-bearing feature of corporate governance in the United States corporate law system.

If shareholder wealth maximization is understood as a workable equilibrium, this suggests there are other equilibrium states. Some may be stable or workable, while others may be unstable, unworkable, or otherwise not desirable.[122] Economic literature provides further clues

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119. Notwithstanding *Dodge v. Ford Motor Co.*, 170 N.W. 668 (Mich. 1919), and *eBay Domestic Holding, Inc. v. Newmark*, 16 A.3d 1 (Del. Ch. 2010), there is still some ongoing debate about the full legal enforceability of the norm (as opposed to its economic function as a norm). *See* Mocsary, *supra* note 1, at 1372. *See also* Hon. Leo E. Strine, Jr., *The Dangers of Denial: The Need for a Clear-Eyed Understanding of the Power and Accountability Structure Established by the Delaware General Corporation Law*, 50 WAKE FOREST L. REV. 761, 764 n.9 (2015).

120. This is somewhat less understudied in the work of contracts scholars. *See* Lisa Bernstein, *The Myth of Trade Usages: A Talk*, 23 BARRY U. L. REV. 119, 126–27 (2018).

121. *Cf.* EASTERBROOK & FISCHEL, *supra* note 31, at 6–7.

122. *See* Edwards, *supra* note 13, at 705.

about stable and unstable or, perhaps, desirable and undesirable equilibria. A famous example might be economist George Akerlof's article about asymmetric information in markets and the "Lemons Problem."[123] In brief, a theoretically optimal equilibrium condition exists where buyers and sellers have symmetric information about a good to be bought and sold.[124] The parties would set the price based upon the shared knowledge about the good and their private knowledge about their utility function. Another equilibrium exists where there is asymmetric information—the seller knows more about the quality of the item than the buyer. The buyer then has to estimate the value of the good on the basis of some sort of population-level probability that the good will be a "peach" or "a lemon."[125] Over time, sellers of "peaches" will slowly leak out of the market as they will not be offered the full value of their peach goods, while sellers of lemons will take over the market, leaving consumers to purchase only lemons—even if ultimately at lemon prices. This is an equilibrium condition, theoretically, because there is now a market full of lemons sold at lemon prices, but it lacks long-term stability because, over time, buyers will find substitutes for the good that is now only available as a lemon.[126] If it is assumed that consumers' utility functions would be satisfied better by peach goods from the lemons-only market, the substitutes will satisfy them less. As Akerlof might have predicted, or at least as later writers claimed, there have come to exist still-imperfect public and private institutions for generating information for markets and other bargaining environments that result in stable, more superior equilibrium conditions.[127] Nonetheless, as it has done many times before, the Lemons example nicely illustrates the way the economics can help to describe and compare alternative potential institutional arrangements in the real world.

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123. *See generally* George Akerlof, *The Market for "Lemons": Quality Uncertainty and the Market Mechanism*, 84 Q. J. ECON. 488 (1970).

124. *Id.* at 492 (describing a greater utility where symmetric information exists, contrasted with asymmetric information).

125. A peach is a high-quality unit of a product, while a lemon is a low-quality unit of the same product. *See generally id.*

126. *Id.* at 489. Another example comes from the work of economist Lester Telser in a contretemps with economists Ben Klein and Kevin Murphy over an antitrust case involving the Coors Brewing Company. *See* Lester G. Telser, *Why Should Manufacturers Want Fair Trade II?*, 33 J. L. & ECON. 409, 413 n.6 (1990).

127. *Cf.* Akerlof, *supra* note 123, at 493–94; DAVID D. FRIEDMAN, PRICE THEORY: AN INTERMEDIATE TEXT 563–95 (1986) (describing "group insurance" where risk is shared and healthy people can be included in the pool at a lower cost to them).

Fashionable though it may be to desire one's theoretically validated social or economic policies to be "efficient" or "optimal," the author persists in claiming only that shareholder wealth maximization is a workable and socially valuable institution, even if it is not optimal by many definitions. As the author has observed previously, ESG—like corporate social responsibility and managerialism and the New Deal before it—has the potential to reconfigure the equilibrium.[128]

II. ALL THINGS ESG—RISK MANAGEMENT OR SURPLUS TRANSFER?—*IF BY WHISKEY*

Mississippi was the first state to enact alcohol prohibition and the last state to end it—the statewide ban on alcohol persisted until 1966, some 30 years beyond the ratification of the Twenty-first Amendment.[129] During one of the contentious debates, a young state senator named Noah S. "Soggy" Sweat delivered a speech to his colleagues on the floor of the Mississippi Senate now known as "If by Whiskey," or "The Whiskey Speech."[130] Sometimes described—or even criticized—as an eloquent equivocation, the speech reflects the complexity of difficult social problems. Though it may seem quaint today, the "drys" and "wets" both had some strong and weak arguments for their positions, and grasping at an equilibrium position is hard.[131] Naturally, each side had some bad faith actors and individuals motivated by counterintuitive beliefs or biases. For example, the coalition of "bootleggers and Baptists" supported the dry side, the former not because of any moral or social belief in the harm caused by alcohol consumption, but because legalizing licensed, bonded, and regulated alcohol would reduce the value of the bootleggers' illegal business.[132]

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128. Edwards, *supra* note 13, at 691–92.

129. U.S. CONST. amend. XXI; Leah Willingham, *90 years later, Prohibition officially ending in Mississippi*, WASH. POST (July 2, 2020), https://www.washingtonpost.com/business/90-years-later-prohibition-officially-ending-in-mississippi/2020/07/02/19f02478-bcb0-11ea-97c1-6cf116ffe26cstory.html [https://perma.cc/KR42-SUQN].

130. Noah S. Sweat, Mississippi State Senator, Address to the Mississippi Legislature (1954).

131. *See generally* Lipsey & Lancaster, *supra* note 18, at 11 (describing, theoretically, the impact of a constraint that would prevent attainment of a condition required for a Pareto-optimal equilibrium).

132. *See* Bruce Yandle, *Bootleggers and Baptists-The Education of a Regulatory Economist*, AEI J. GOV'T & SOC. 12, 13–14 (1983) (describing the incentives of "bootleggers," "Baptists," and lawmakers/regulators in alcohol regulation).

This Part suggests the analysis, if not wisdom, of Senator and later Judge, and even later law Professor, Sweat in describing the scene passing in front of him. As he implied in his speech, the work of carefully evaluating and analyzing both sides' good-faith positions never really stops. As Professors Padfield, Schanzenbach, and Sitkoff describe, it will ultimately matter a lot whether ESG is merely an improved method of maximizing shareholder value by weaving in additional margins, or whether it involves a surplus transfer from shareholders to stakeholders, or to managers themselves. This Part sketches a necessarily vague-at-the-edges definition of ESG, hoping to clarify some of the abstractions by evaluating current efforts and notable successes in operationalizing ESG commitments.

A. What is ESG? And does a precise definition matter?

Compared to the framework of shareholder wealth maximization as the ends of corporate governance, ESG suggests broadening the scope of managerial activity. Environmental governance suggests that managers evaluate the relevant corporation's impact on the environment and take reasonable steps to mitigate the corporation's contribution, specifically, to carbon emissions. Social governance encompasses both traditional and more novel elements. Traditional corporate social responsibility factors, reflected in Professor Bratton's theory of the mid-century social compact, include such matters as the relations between the corporation and its employees and local communities. Certainly, ESG proponents include labor issues in their approach to corporate governance, generally supporting higher wages, better working conditions, more recognition of labor unions, and related matters. Modern social governance also includes more novel factors such as diversity, equity, and inclusion or "DEI." DEI includes moving beyond developing practices that avoid employment discrimination liability under Title VII of the Civil Rights Act of 1964, to, for example, taking active steps to promote an employee census that more accurately matches the race, gender, and other identity factors present in the local or national community.[133] Of course, ESG proponents do not necessarily support ignoring shareholder value altogether. They propose to generate norms and practices that account for environmental and social impacts of corporate activity.

The edges may be vague, but the core must be one of two things: either ESG actually is an improvement to corporate governance by expanding

133. *See, e.g.*, Alicia E. Plerhoples, *ESG & Anti-Black Racism*, 24 U. PA. J. BUS. L. 909, 919–20 (2022) (cataloguing DEI approaches).

the margins of shareholder wealth maximization such that the rising tide of renewed interest in stakeholders results in the lifting even of the shareholders' boats, or it is a reallocation of corporate surplus from shareholders to both stakeholders and managers. While it may be tempting to suggest that the former is improbable due to it not having emerged yet, that suggestion would prove too much for at least two reasons. First, scholars with immense practical experience advising corporate directors describe directors' decision processes as deliberative, thoughtful, and all-encompassing, not necessarily as acting as though they strictly follow a specific shareholder wealth maximization function.[134] Furthermore, American corporations have substantially increased ESG efforts in the past half-decade, with no obvious correlations suggesting this has resulted in reduced shareholder or overall economic wealth.[135] Second, it could just be that this was the moment that the information about the positive correlation between ESG and shareholder wealth finally revealed itself clearly enough.

Even so, there is reason to doubt that, on the whole, ESG is just better risk management, a superior or more precise net present value function,[136] or a profound discovery that doing good and doing well are actually correlated. The question need never have been whether doing good for society was good—it seems agreed that it is. The better question always has been whether business corporations are the best-equipped institutions to do good. Even if corporations are a locus of one of the important pieces of equipment for doing good, money, they may not be the best equipped to spend it. The answer has long been thought to be "no," but, again, this could be changing. Perhaps the answer lies in Professor Ann Lipton's observations that shareholders may demand that corporations take action to protect non-shareholder constituencies or otherwise engage in welfarist activity not directly related to shareholder value because the political processes for regulating corporate activity may not be functioning well enough to do so.[137]

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134. *See, e.g.*, Joan M. Heminway, *Shareholder Wealth Maximization as a Product of Statutes, Decisional Law, and Organic Documents*, 74 WASH. & LEE L. REV. 939 (2017); Jeffrey M. Lipshaw, *The False Dichotomy of Corporate Governance Platitudes*, 46 J. CORP. L. 345 (2021).

135. James E. Hartley, *Book Review: Get Woke, Go Broke?*, L. & LIBERTY (July 17, 2023), https://lawliberty.org/book-review/get-woke-go-broke/ [https://perma.cc/7C9X-AYKX].

136. Padfield, *supra* note 7, at 441.

137. Lipton, *supra* note 32, at 880. *See also* Ann M. Lipton, *In anticipation of Thanksgiving*, BUS. L. PROF. BLOG (Nov. 22, 2014), https://lawprofessors.typepad.com/business_law/2014/11/in-anticipation-of-thanksgiving.html [https://perma.

The other possibility, developed more thoroughly in Part III, is that ESG's greatest benefit is to a class of corporate constituents not often thought of as constituents or stakeholders at all: corporate managers themselves. That is, as they have done in the past with expensive office furnishings or use of the private jet, managers may compensate themselves by spending corporate resources on ESG. Within the broad discretion corporate managers possess to allocate the firm's resources, they will inevitably allocate some of those resources to themselves.[138] The business judgment rule, procedural requirements for derivative actions, and high bar for showing breach of the duty of loyalty reflect the limitations of the legal system to disincentivize this allocation.[139] Likewise, transactions costs in the market for corporate control leave space for small diversions of surplus. Perhaps if an officer is diverting too much surplus, independent directors could chasten the officer, though this is doubtful.[140] Naturally, these diversions cannot be unlimited because ultimately the relatively low transactions costs in the capital markets will result in lower stock prices for firms with managers engaging in too much diversion, leading to potential board action or a takeover bid. But a relatively small amount of surplus diverted, where monitoring costs are high, can benefit the individual manager considerably. Thus, this Article's analysis is that it is doubtful that ESG is simply a better way to do business from a shareholder wealth perspective. Instead, it appears to result in a reallocation of surplus away from shareholders. The author cautions that this does not necessarily mean that overall social wealth will be reduced—perhaps the increased attention to ESG, plus the social perquisites to corporate managers, are more valuable than the loss of wealth to shareholders. Or the gain to society from the corporate machinery being operated on ESG terms will outweigh the losses to shareholders.

This initial definition of ESG is necessarily vague and a bit dualistic. ESG is an abstract idea and an evolving theory of the corporation and its role in society. A more precise definition than this one is possible, and since ESG is here to stay, it is doubtless that scholarly shaping of the

cc/BJ6U-PR7W] (citing Mariana Pargendler, *The Corporate Governance Obsession*, 42 J. CORP. L. 359, 365–66 (2016)).

138. *See generally* Manne, *supra* note 10, at 117.

139. *See* Bunting, *supra* note 23, at 268–69 (describing the limitations of fiduciary duty litigation and other legal mechanisms to discipline corporate managers in the analogous case of using corporate resources to engage in speech in support of social responsibility).

140. *See* Lucian A. Taylor, *CEO Wage Dynamics: Estimates from a Learning Model*, 108 J. FIN. ECON. 79 (2013) (describing that CEO pay does not decrease even when firm performance poor).

theory will continue apace. But, at the moment, this Article rests on these general points: ESG, at minimum, means reconfiguring corporate managerial decision-making to account more broadly for impacts on the environment and society as a whole. It could either be a marginal improvement by expanding the margins of shareholder wealth maximization and/or a surplus transfer or leakage from shareholders to other stakeholders and managers, or it could be both. The ultimate answer may not be empirically clear for some time. Perhaps this is as Senator Sweat's wisdom would portend.

B. ESG Metrics, and do precise metrics matter?

Business is a numbers business. Modern board decision-making, perhaps as it has always been, is based in part upon directors exercising business judgment with appropriate quantitative data in hand. For example, approving a merger without reading the financial data has long been thought grossly negligent.[141] Unsurprisingly, managers and directors looking to implement ESG are looking to do so with quantitative methods that permit measurement of the business's ESG performance, in the same way that the income statement reveals financial performance. Setting aside the thorny question of whether the SEC has the statutory authority to require disclosure of ESG performance,[142] it has been looking for metrics that would provide useful information to investors about various corporations' ESG performance.[143]

As perhaps foreshadowed by the immediately preceding section, the author is somewhat agnostic on whether precise metrics matter for ESG purposes. If ESG is simply attempting to use our typical quantitative business tools—e.g., Professor Padfield's net present value approach—to develop a useful measurement for corporate impact on the environment, labor markets, DEI, and other similar matters, then perhaps finding the

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141. Smith v. Van Gorkom, 488 A.2d 858, 874 (Del. 1985).

142. *Cf*. George A. Mocsary & John P. Anderson, *An Economic Climate Change?*, L. & LIBERTY (Nov. 8, 2021), https://lawliberty.org/eco-disclosures/ [https://perma.cc/5BWW-YNH3]; Comment Letter of Securities Law Professors on the Enhancement and Standardization of Climate-Related Disclosures for Investors to Vanessa A. Countryman, Secretary of the U.S. Sec. & Exch. Comm'n (June 6, 2022), https://www.sec.gov/comments/s7-10-22/s71022-20130354-297375.pdf [https://perma.cc/6BK8-GLJX].

143. *See* Mocsary & Anderson, *supra* note 142 (describing the statements of SEC Chair Gary Gensler about investor demand for ESG disclosures). *See also* Ann M. Lipton, *Mixed Company: The Audience for Sustainability Disclosures*, 107 GEO. L.J. ONLINE 81, 87 (2018).

right metrics is mission critical. Notably, there are numerous organizations providing metrics, or at least grades, to various corporations on their ESG activities or on specific aspects.

As described in a 2022 article by finance professors David F. Larcker, Lukasz Pomorski, Brian Tayan, and Edward M. Watts, the ESG rating industry is vast and fragmented. Professors Larcker, et al., identify the most prominent ratings providers as MSCI, ISS, Sustainalytics, Refinitiv, and FTSE Russell.[144] These ESG ratings providers make varying claims about their metrics, but they seem to coalesce around a common belief that their main ESG ratings reflect the purpose Professors Schazenbach and Sitkoff describe as risk management ESG.[145] Furthermore, some research shows that improved ESG risk management approaches may have the effect of increasing returns.[146] The question of whether ESG does or should improve shareholder wealth maximization, or whether it results in a surplus transfer across corporate constituencies, is not apparently a major piece of the empirical work in the area.[147]

Outside of these broad-based ESG metrics and formulas, identity groups and advocacy organizations promulgate best practices and provide ratings. One example is the Human Rights Campaign (HRC), an LGBTQ+ advocacy organization that issues its "Corporate Equality Index" or "CEI."[148] The CEI scores corporations based upon their commitment to equality for LGBTQ+ persons across multiple facets, including employment policies and corporations' stated public policy positions.[149] It also includes increased points for providing financial or in-kind support to LGBTQ+ organizations and causes, as well as supplier diversity initiatives and support for equality legislation.[150] The score is on a scale of 100.[151]

144. LARCKER ET AL., *supra* note 2, at 2–3. These authors also identify another set of providers for a total of nine ratings providers, which they describe as just a few of the providers out there. *Id.*

145. *See, e.g.*, *What is an MSCI ESG Rating?*, MSCI, https://www.msci.com/our-solutions/esg-investing/esg-ratings [https://perma.cc/PR2W-7NXE] (last visited Jan. 12, 2024) (describing MSCI's ESG ratings as aimed at "measur[ing] a company's management of financially relevant ESG risks and opportunities").

146. LARCKER ET AL., *supra* note 2, at 3. *See also* MSCI, *supra* note 145; Monica Billio et al., *Inside the ESG ratings: (Dis)agreement and performance*, 28 CORP. SOC. RESP. MGMT. 1426, 1427–28 (2021).

147. Billio et al., *supra* note 146, at 1427–28.

148. *2023 Corporate Equality Index Criteria*, HUMAN RTS. CAMPAIGN, https://www.hrc.org/resources/corporate-equality-index-criteria [https://perma.cc/4HZC-P8DY] (last updated Nov. 30, 2023).

149. *Id.*

150. *Id.*

151. *Id.*

Corporations scoring highly on the scale are rewarded with positive publicity, while a negative action in the view of the HRC might result in removal of the high rating.[152]

Though it is not a simple task to quantify the incentive mixture emanating from ESG metrics providers, it stands to reason that corporate managers are incentivized in several ways to respond to these metrics. These metrics permit or require managers to maximize along several margins—increasing the corporation's ESG score or enjoying the accolades that accompany receiving a high score. Setting aside the question of whether this is socially optimal, for now, this is likely an accurate enough description of the potential incentive structure at work.

III. MANNEAN MANAGER COMPENSATION AND MANNEAN SURPLUS FROM ESG ACTIVITIES

As described earlier, Dean Henry Manne's early scholarship on corporate law and governance delivered a much more detailed picture of the law and economics of the firm than had existed before.[153] Judge Easterbrook and Professor Fischel credit Dean Manne's work as foundational to their own.[154] This Article extracts one aspect of Dean Manne's work, namely, his consistent application of marginal maximization to the players within a corporation.[155] Dean Manne is perhaps most well-known for coining the term and developing the concept of "the market for corporate control."[156] In brief, Dean Manne observed that the ability to control the assets of a corporation was itself an economic asset or property right.[157] At least with respect to corporate stock, traded in the relatively low-friction and liquid stock market, that property right could be bought or obtained at a relatively lower cost.[158]

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152. *Id. See also* Dee-Ann Durbin, *LGBTQ+ group suspends Bud Light maker's rating over handling of backlash to transgender influencer*, ASSOC. PRESS (May 19, 2023), https://apnews.com/article/bud-light-dylan-mulvaney-transgender-influencer-1ade61f1b70941d042b46449c32a3c9b [https://perma.cc/58GY-8C3H].

153. William Carney, *The Legacy of "The Market for Corporate Control" and the Origins of the Theory of the Firm*, 50 CASE W. RES. L. REV. 215, 225 (1999).

154. EASTERBROOK & FISCHEL, *supra* note 31, at 174 n.6.

155. *See* Leeson, *supra* note 10, at 1 (describing Professor Barzel's application of maximization to his study of property rights).

156. *See generally* Manne, *supra* note 10.

157. *Id.* at 112.

158. *See id.* at 112–13.

Critically for the purposes of this Article, Dean Manne observed that managers could maximize along different margins within a range where the risk of sinking the stock price to a level where a takeover could occur was low.[159] That is, they could divert corporate surplus to themselves to the extent doing so did not so depress the stock price that they risked a takeover. Similarly, Dean Manne applied this reasoning to explain how insider trading "compensates" internal entrepreneurship.[160] Once again, Dean Manne supposed that access to private information about an upcoming material change in circumstances involving the corporation could very well be baked into a manager's compensation, just like, for example, the right to renovate the corporate offices or private jet with expensive, luxurious, and personalized trappings.[161] This Part describes these two examples of Dean Manne's approach, illustrating the power of his application of maximization. Then, it updates Dean Manne's application of that analysis to social causes—indeed, Dean Manne himself observed during one of the prior debates about corporate social responsibility that managers could consume the benefits of "corporate statesmanship." It concludes that ESG could be another margin along which managers could maximize their overall compensation from managerial employment. Then, it analyzes whether this form of managerial compensation and the incentives it creates can assimilate into the existing equilibrium of shareholder wealth maximization.

A. The Market for Corporate Control—Managers maximize their enjoyment of managerial control.

Mergers and the Market for Corporate Control (*Mergers*) stands as one of Dean Manne's most prominent works.[162] While *Mergers* began with a typical, for its time, argument that antitrust enforcement was too suspicious of mergers of competitors,[163] Dean Manne noted that his forthcoming insights about managerial efficiency and compensation would perhaps be more applicable as a rejoinder to Berle and Means's concerns about the separation of ownership and control.[164] Dean Manne described the arena in which mergers took place not as a simple economic model where firms represent black-box units within a typical partial or

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159. *Id.* at 117.

160. *See generally* Manne, *supra* note 9.

161. *Id.* at 5; MANNE & WALLACH, *supra* note 12, at 20.

162. Manne, *supra* note 10, at 110–11.

163. *Id.* at 110–12. *See, e.g.*, Robert H. Bork & Ward S. Bowman, *The Crisis in Antitrust*, 65 COLUM. L. REV. 363, 373 (1965).

164. Manne, *supra* note 10, at 112.

general equilibrium context.[165] Instead, he began by applying the deceptively simple economic reasoning that stock prices reflect many things, including the efficiency, skill, and competence of the managers.[166] This unfolded into two observations: first, that the right to earn managers' compensation was at stake in a merger, and second, that superior management could maximize the value of the underlying business, thus creating a profit for anyone willing to buy the "depressed" stock of the poorly managed corporation, manage it better, then sell it at the resulting higher price or enjoy the surplus from improved operations.[167]

Dean Manne's development of the theory of the market for corporate control was in large measure a response to legal scholars' assertions that there were no effective limits on managers, leading, for example, Professor Berle to propose that the only answer was some sort of trusteeship or, later, corporate statesmanship.[168] Though Berle and Means are often associated with a shareholder primacy norm, their closest solution to the agency costs problem was managers simply being publicly or politically cajoled into acting in the benefit of shareholders.[169] But, by the time Dean Manne began writing, Berle had moved to a corporate statesmanship model involving public consensus to do good with corporate power.[170] A corporate statesman, like a political statesman, will allocate resources among stakeholders via a public-like consensus. That public-like consensus would emanate from a sphere of public belief often associated with the political system or process. Corporate managers, sensitive to social consensus, must obey the public, lest the public later use the political processes to invoke a government solution.[171]

Other works have comprehensively revisited and rehashed the debate throughout the century, so this Article will focus only on the aspect of Dean Manne's work of which, perhaps the author should concede, even Dean Manne appeared less certain. Dean Manne was skeptical of true corporate altruism, suggesting that any corporate altruism that was not motivated by profit maximization in some direct or indirect way would

165. *Id.* at 111–13.
166. *Id.* at 110–12.
167. *Id.* at 113.
168. Berle, *supra* note 65, at 1049; Henry Manne, *The "Higher Criticism" of the Modern Corporation*, 62 COLUM. L. REV. 399, 414 (1962).
169. BERLE & MEANS, *supra* note 68, at 276, 354.
170. Bratton, *supra* note 26, at 770.
171. *See* Sale, *supra* note 32, at 1032–33.

quickly be competed away.[172] The only exception he thought possible lay in the extent to which the corporate manager could conceal some of his or her own consumption of business resources via less visible perquisites.[173] In brief, Dean Manne theorized that high managerial salaries are visible to shareholders and the public, suggesting a limit to how much dollar compensation a manager could allocate to himself or herself before inviting a potential takeover. Of course, a manager could avoid such scrutiny by "giving away" more resources to shareholders through dividends, thus insulating the manager against the market for corporate control. In the in-between space, managers can also consume corporate resources via perquisites such as office furnishings—perhaps in today's parlance, profligate use of the corporate jet. It is in this space that Dean Manne situates the ability to allocate resources to ostensibly socially responsible causes.[174] Dean Manne proposes that allocating resources to these socially responsible causes can either generate positive utility for the manager by allowing the manager to enjoy being perceived and treated as a good corporate executive or, conversely, stave off some unpleasantness or disutility from being considered the opposite.[175]

B. Insider trading compensates internal entrepreneurship.

To the extent Dean Manne is not well known for his re-theorizing of the corporation in the 1960s, he is also famous for his persistence in arguing that there was nothing particularly harmful about insider trading.[176] In his 1966 book, *Insider Trading and the Stock Market*, Dean Manne explained and described numerous positive effects on the stock market that might materialize in the absence of prohibitions on insider trading.[177] Dean Manne theorized that information that would impact the future value of a corporation's publicly traded shares would be generated inside the corporation. As soon as that information came into being, the information itself became of value, a function in some way of its ultimate expected impact on the market price of the shares. Assuming that some

172. Manne, *supra* note 168, at 416; Henry G. Manne, *Corporate Responsibility, Business Motivation, and Reality*, 343 ANNALS AM. ACAD. POL. & SOC. SCI. 55, 60 (1962).

173. MANNE & WALLACH, *supra* note 12, at 25–26.

174. *Id.*

175. *Id. See* ASSOC. PRESS, *supra* note 152 (suspension of Anheuser-Busch HRC rating).

176. *See generally* HENRY MANNE, INSIDER TRADING AND THE STOCK MARKET (1966).

177. *See generally id.*

form of the efficient market hypothesis holds, the market price of the shares trading in the moment after the information exists but before it is made public would not accurately reflect information about the stock. So, Dean Manne argued, insider trading permits the information to reach the market, which, in turn, inures to the benefit of other shareholders.[178]

His primary contribution, sometimes overlooked, is that insider trading is a method of compensating internal entrepreneurship. Economic thought in Manne's time reflected concerns that the corporate structure was such that there was no way to compensate internal entrepreneurship.[179] Often corporate employees make fixed salaries, perhaps with some bonuses, but in no case does any corporate employee enjoy anything near the total surplus generated from the employee's in-house entrepreneurship. This is not necessarily a problem in and of itself because the entrepreneurial surplus is certainly owed in some part to the investment from the corporation, but generally corporations assert a claim to all surplus from an internal entrepreneurial action. Naturally, this creates a disincentive to entrepreneurship within the corporation, a problem that corporations have arguably tried to solve through bonuses, stock options, and similar approaches to motivating employees and aligning employees' interests with the firm. Dean Manne argued that the ability to trade in the corporation's stock, and specifically to do so with private information associated with entrepreneurial successes the corporate employee generated, would supply a less costly compensation mix than one premised upon any of the numerous ways corporations have sought to align incentives.[180]

Dean Manne's views on insider trading remain the minority, and the SEC has not shown any interest in scaling back its enforcement.[181] Dean Manne's normative conclusions notwithstanding, the key thread from his work on insider trading is the persistent and rigorous application of individual maximization to the acts of individuals in supposedly fiduciary or other-regarding capacities.[182] Consequently, ESG may be better

178. *Id.* at 60–62 ("More accurate" pricing is sometimes considered a "positive externality" of private transactions. In contrast to typical externalities, where some cost of a private transaction is not fully internalized by the parties to the transaction, a positive externality is one where a gain cannot be fully captured, leaving it to be exploited by non-parties).

179. Manne, *supra* note 9, at 9–12.

180. *Id.* at 15.

181. *See generally* Kevin R. Douglas, *How Fatal Ambiguity Undermines Effective Insider Trading Reform*, 48 J. CORP. L. 353 (2023).

182. *See, e.g.*, Jensen & Meckling, *supra* note 97, at 307.

understood by using Dean Manne's lens: the individual incentives of the people pursuing ESG goals within corporations.

C. Applying it to ESG.

Dean Manne wrote about corporate social responsibility, the market for corporate control, and insider trading, among many other things. Marginal maximization animated his logic on each of these subjects. Dean Manne showed that corporate managers, like anyone else, make choices from among a constrained menu of options. This happens dynamically, on a day-in, day-out basis. One of the main points of this Article is to illustrate how ESG and accepted ESG metrics impact the marginal choice architecture facing the corporate manager. Dean Manne's logic applies cogently to modern ESG. This Article's primary argument is that corporate managers will allocate resources to ESG to consume the perquisite of social status, or at minimum, to retain their ability to consume other perquisites of corporate management. Notwithstanding the possibility that integrating ESG into corporate wealth maximization would not be a zero-sum game, managers should be expected to consume surplus until the risk that their consumption of surplus would trigger an unacceptable flight of capital. But, it should be noted that, undoubtedly, some corporate managers will allocate resources to ESG grudgingly to avoid the discomfort of finding themselves and their corporations on the wrong end of negative public relations associated with actual or perceived ESG shortcomings. This Part analyzes modern ESG in terms of a manager allocating resources within the manager's role in the corporation. Managers will allocate resources to ESG to avoid disutility and to consume surplus in the form of investing corporate resources for social status, the latter of which might be understood as compensation.

1. The Resource Allocation Decision

Corporate managers make resource allocation decisions. This is a core feature of the corporate contract and an expectation underlying corporate law. As is now well-understood, corporate managers are also individuals who have their own utility functions. This is why so much research on corporate managers involves how to align their incentives with the corporation and its shareholders and part of why the law applies a fiduciary duty framework to the relationship.

When making resource allocation decisions, managers will choose those decisions which may maximize the value of the firm, benefit them personally, or both. Most decisions will contain benefits flowing in both directions, and, so long as benefits to the corporation and shareholders obtain, managers can divert some surplus to themselves. The more a decision appears to be self-enriching without benefitting the shareholders, the more risk of capital flight. This choice set exists for every corporate manager, so if there is a decision that can bring the manager greater personal utility while also avoiding the prospect of shareholder dissent, the manager will be incentivized to make that decision.

Various institutions develop and publicize ESG metrics.[183] Sometimes they are described as "scores" or appear like "grades" on a scholastic scale: A or B+ and so on. This introduces a new variable into the corporate manager's choice architecture: business decisions now must be considered for their impact on the corporation's ESG scores or, at minimum, considered for their expected impact on ESG issues. Indeed, less metrified public pressure may come in the form of threatened boycotts or other campaigns. Managers should be expected to respond, and this is likely already observable.[184] Notably, this is not a substantial departure in logic from criticisms of corporate executives who focus on the next quarterly disclosure and its concomitant impact on stock prices. Put in terms of Dean Manne's theory of corporate social responsibility, responding to ESG activism and ESG scoring is a way for individual managers to gain utility or avoid disutility.[185]

Within Dean Manne's marginal maximization framework, corporate managers maximize their overall individual compensation from corporate employment.[186] Faced with a menu of choices, corporate managers will make the selections most likely to maximize their lifetime of compensation from corporate employment. At every time where ESG, or CSR, or corporate statesmanship, has become socially salient, corporate managers have confronted resource allocation decisions that implicate ESG and thus must have had it in their choice architecture. Thus, to maximize their overall lifetime compensation, corporate managers will have to consider allocating corporate resources to ESG.

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183. *See supra* Part II.B.

184. For example, Anheuser-Busch InBev faced a backlash by partnering with transgender rights activist Dylan Mulvaney for a small social media marketing campaign. In response, the corporation distanced itself from Mulvaney. After this distancing, the Human Rights Campaign suspended scoring Anheuser-Busch InBev from its "CEI" scoring program, which came with it the entitlement to advertise as a "Great Place to Work" for LGBTQ+ persons. Prior to the suspension of the score, Anheuser-Busch InBev had sported a perfect 100 score. *See* ASSOC. PRESS, *supra* note 152.

185. MANNE & WALLACH, *supra* note 12, at 25–26.

186. Manne, *supra* note 9, at 5.

As described above, this dynamic is contractual in nature, and the tacit norm is that generally corporate managers will make resource allocation decisions with the value of the corporation as the paramount interest. But, of course, there is always space for the manager to make decisions that are self-enriching to a point. Finally, it bears repeating that allocating resources to ESG goals may or may not be socially optimal, but the mechanism must work in this manner. The rest of this Part illustrates how the resource allocation decision that diverts resources into ESG goals can enrich managers.

2. ESG and the Manager's Utility Function

Because corporate managers, and directors, have the authority to allocate corporate resources, they can allocate some to themselves to the exclusion of shareholders and other stakeholders. Naturally, a manager makes the choices available to him or her to maximize along all relevant margins. It is possible, then, that having to pay attention to the ESG implications of various business decisions upsets this equilibrium in a manner that will cause corporate managers to act defensively. That is, managers will allocate resources to ESG to avoid disutility from negative press or public and private pressure to allocate resources to ESG. Of course, it is possible that this sort of personal disutility-avoidance is aligned with corporate interests. If a corporation's customer base or labor force is particularly engaged on ESG issues, taking an ESG-related social position might be superior to not taking any stance at all. In that case, perhaps, allocating resources to ESG will result in a net gain, given the potential losses from failing to sufficiently pursue ESG. Another scenario bears noting. If allocating more corporate surplus to ESG prevents the manager from facing criticism, this may preserve the manager's total compensation despite poor performance along any margin. Indeed, there is some evidence that managers may seek to allocate more resources to ESG when the firm is suffering financially. If doing so preserves the manager's job or perquisites, the manager will do this to the exclusion of shareholder value, not to mention other stakeholders.

The other incentive is for managers to compensate themselves with social status from corporate employment. As with its avoiding discomfort counterpart, managers may increase their utility by gaining status through allocating resources to ESG. Furthermore, they may be able to "spend" more on surplus with an ESG-related purpose than they could spend on things that conspicuously benefit themselves. Indeed, this is a variation on the familiar "greenwashing" or "rainbow-washing" argument, which suggests that corporations and their managers may be buying good press for themselves and their corporations through committing some resources to ESG matters without making any major measurable progress toward the underlying goals.[187] While the corporation may enjoy increased brand value from such expenditures, this brand value investment may not be the next-most profitable investment of corporate resources.[188] Since the managers may also enjoy the social status generated through these ESG activities, this outcome would incentivize them to continue or increase allocations to such activities.

Moreover, public corporation managers in the United States come from a particular social class, are educated at the same class of institutions, and tend to be involved in the same or similar social activities.[189] To the extent that ESG-related social beliefs have taken root among this class, it would be expected that they have taken root among corporate managers. Assuming this is the case generates the conclusion that corporate managers can and will expend corporate resources on ESG efforts to avoid negative social sanction from being insufficiently attuned to their social norms and enjoy social perquisites from spending corporate resources on the socially correct causes.[190] Further still, these expenditures may be relatively less costly in terms of the market for corporate control and less conspicuously self-enriching like salaries, stock options, and corporate jet usage. Naturally, this would mean that corporate managers could spend more on ESG social capital building than they could on flying around in the corporate jet or attending sporting events in the corporate suite or simply receiving greater stock options.

Moreover, this incentive set filters down the corporate hierarchy. Often, corporate managers reach the highest levels of management through promotions within their corporations or by moving between corporations to obtain a higher position. If promotions and advancement within the corporation or in corporate employment generally are linked to ESG-related goals and proficiency, lower-level managers likewise will seek to achieve them.[191]

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187. *See, e.g.*, John Towers Rice, *Rainbow-Washing*, 15 N.E. U. L. REV. 285 (2022).

188. MANNE & WALLACH, *supra* note 12, at 13.

189. *See, e.g.*, Michelle K. Lee et al., *Social Class in Organizations: Entrance, Promotion, and Organizational and Societal Consequences of the Corporate Elite*, 30 J. MGMT. INQUIRY 385 (2021).

190. *Cf.* Stefan Padfeld, *Corporate Governance and the Omnipresent Specter of Political Bias*,104 MARQUETTE L. REV. 47, 76 (2020).

191. *See generally* Andrew Winston, Paul Polman, & Jeff Seabright, *Middle Management is the Key to Sustainability*, HARV. BUS. REV. (2023), https://hbr

In sum, Dean Manne observed that managers, like everyone else, maximize their total compensation—as he put it, "every benefit or positive utility . . . offered up on one side of the employment contract."[192] If maximizing ESG either protects managers from bad press, or increases their social status, and in both cases preserves their perquisites of corporate office, they should be expected to expend corporate resources on ESG when in a position to spend those resources. Doing so increases managers' overall compensation over their career arc in corporate employment. This may or may not result in improved shareholder value, improved stakeholder outcomes, a wealthier society, or a better society along any other nominal dimensions of ESG.

D. A Stable, Desirable Equilibrium?

It would be a bridge too far to claim that corporate directors and managers were, until a few years ago, myopically focused on shareholder wealth maximization as measured by stock price, discounted cash flow projections, or other net present value investment metrics.[193] Often, as Professor Bainbridge has observed, all stakeholders win in resource allocations within a given corporation; indeed, this is part and parcel of the overall process of maximizing the value of the corporation.[194] Consuming perquisites in the short run to the extent doing so does not risk board action or the market for corporate control is not new. Combining the author's prior observations and the preceding discussion of Dean Manne's maximization framework, the upshot of this Part is that directors and managers of corporations, fundamentally profit-making enterprises, will probably assimilate growing ESG incentives and disincentives into the existing process of maximization. It seems possible that this could reflect a stable equilibrium state for the corporate contract as a whole or even an equilibrium state where managers are more efficiently compensated with social status rather than with additional potential shareholder dollars. For the reasons set forth throughout this Part, the author finds this questionable at best.

As set forth in Part I.C, the author describes the relationship between shareholders and directors as a multiple equilibrium bargaining and

.org/2023/11/middle-management-is-the-key-to-sustainability [https://perma.cc/W5FB-23NP].

192. Manne, *supra* note 9, at 5.

193. *See, e.g.*, Padfield, *supra* note 7, at 441. *But see* Billio et al., *supra* note 146, at 2–3.

194. Stephen M. Bainbridge, *Making Sense of the Business Roundtable's Reversal on Corporate Purpose*, 46 J. CORP. L. 285, 309 (2021).

coordination environment.[195] The criteria for a stable equilibrium and an unstable one is somewhat open-ended, but the shareholder wealth maximization regime appears relatively stable. Within the for-profit corporation domain, shareholders providing capital in exchange for a return works—everyone understands that the directors and managers are here to generate returns to the capital of the corporation, which benefits the shareholders, and not do something else.[196] This equilibrium should be compared to proposed different equilibria where boards pay more attention to ESG principles, or at least ESG metrics.

To that end, perhaps ESG could be understood as an informationally enriching trend. Climate change, inequality, and other concerns captured in ESG metrics were previously uncaptured in relevant analyses, and now that they are more legible,[197] they are increasing value of the relevant bargains. For example, perhaps ESG metrics are solving a longstanding problem in economic activity, that of externalities.[198] Of course, externalities are considered a problem because the costs of economic activity are not borne by the producers of the activity. Carbon producers offload the cost of the increased carbon emissions. That means that carbon-producing activities are over-produced compared to the optimal amount that would exist if costs were internalized. Aside from increased profits flowing to externality producers that internalizing the costs would reduce, one of the reasons that carbon producers offload the carbon onto the environment is the cost of computing the cost to the environment as a whole from any individual transaction's carbon production and emission. In the proverbial calculus, the transaction is surplus-creating on paper because the cost of production simply does not include a line item for social cost. Critically, this is not necessarily because the transactors consciously wish to freeload on the environment or society, but because there was simply no way to bring it into the calculus accurately. If ESG metrics in some way accurately reflect the previously illegible externality costs, this would at least potentially result in a superior allocation of society's resources than before.[199]

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195. *See supra* Part I.C; Edwards, *supra* note 13, at 692.

196. Edwards, *supra* note 13, at 692.

197. Amanda Parsons, *Cryptocurrency, Legibility, and Taxation*, 72 DUKE L.J. ONLINE 1, 11 (2022) (using the concept of legibility to describe the challenge facing taxing authorities as they attempt to tax cryptocurrency and blockchain transactions). *See generally* JAMES C. SCOTT, SEEING LIKE A STATE: HOW CERTAIN SCHEMES TO IMPROVE THE HUMAN CONDITION HAVE FAILED (1998).

198. *But see* Coase, *supra* note 88.

199. *See generally* ARTHUR C. PIGOU, THE ECONOMICS OF WELFARE (1932). *But see* Coase, *supra* note 88, at 34.

Another point bears noting: another possible equilibrium state where managers maximizing their individual compensation via ESG is stable and desirable. As Dean Manne proposed, permitting unfettered insider trading by employees could compensate internal entrepreneurship more efficiently than bonuses, raises, promotions, stock options, or other methods corporations use to raise the returns to internal entrepreneurship.[200] Similarly, permitting some level of ESG investment by managers could represent a more efficient compensation scheme than simply paying more money or granting more stock options. If managers enjoy consumption of social status via ESG efforts, the cost to shareholders and society may be less than the sum of increased compensation of the usual kinds.[201]

As with all institutional arrangements, there might be a particular set of corporations or individuals who "lose" while society "wins." For the reasons described in this Part, a corporate governance regime with fully integrated ESG goals could be the superior institutional arrangement. This potential outcome seems doubtful for several reasons. To begin, it is hard to imagine the pre-ESG corporate condition as one lacking in information about ESG matters, especially given how many ESG metrics seem to align with other financial metrics.[202] There have been questions about the social cost of industrial scale corporate activity since the dawn of industrial scale corporate activity.[203] One of the more intriguing proposals for carbon emissions over the years has been a "Pigouvian" tax, named for the economist Arthur Pigou, to whom Professor Coase was responding in his famous 1960 article *The Problem of Social Cost*.[204] Notably, much of modern administrative law and the work of the federal administrative agencies arose as a supposed public solution to these social costs. The Environmental Protection Agency is an obvious example, but the much earlier National Labor Relations Act and Board were ostensibly created to create a process that prevented violence and economy-imperiling industrial labor strikes. Securities regulations filled various perceived gaps in the candor corporate fiduciaries might be expected to possess if they were Professor Berle's trustees. Indeed, as Berle observed 30 years after his famous book, the public and political process of managing corporation-society relations appeared well-established mid-century.[205] Critically,

200. Manne, *supra* note 9, at 12.

201. *Cf.* Coase, *supra* note 88, at 34 (describing the "proper procedure" for comparing different institutional arrangements).

202. *E.g.*, LARCKER ET AL., *supra* note 2, at 2.

203. *See, e.g.*, BERLE & MEANS, *supra* note 68, at 3.

204. *See supra* note 199.

205. *See* Berle, *supra* note 74, at 433–34.

though, that arrangement had costs just as the pre-ESG arrangement had costs, some of which may be the reason ESG has emerged. The right question is not whether ESG's principal goals or the desires of its proponents are good or bad, but which set of rules and institutional arrangements work best in light of their relative costs. This Article concludes that the current, stable, workable equilibrium is likely superior to an ESG equilibrium, where managers may divert corporate surplus to themselves by spending resources on ESG matters instead of increasing shareholder value or returning the surplus to shareholders via dividends.

CONCLUSION

ESG's impact on corporate law and governance can be understood in terms other than just whether fiduciary duty requires or prohibits it, whether a securities regulation regime can or should require disclosures relating to it, or even whether ESG and the corporate responsibility ethos it brings to the table is a net social good. The first question is the extent to which corporate directors, senior managers, and even middle managers now face greater incentives to use corporate resources to invest in their personal social capital both within corporations and within their social environments. While this has always been a perquisite of high-level corporate employment, it does matter how closely, or not closely, aligned the diversion of surplus into personal perquisites is to the ultimate value of the corporation to its shareholders. The second question, with two parts, is whether ESG, implemented as it must be by managers, is actually a workable equilibrium and whether that equilibrium is superior institutionally to a consistent shareholder wealth maximization institution. This Article concludes that while ESG could manifest in some workable tweaks to the shareholder wealth maximization institutional structure, any part of ESG that represents a wholesale reorientation of the maximand is likely an inferior organization. Moreover, compensation of corporate managers in social status from ESG activities is an inferior approach to other forms of compensation, even viewed as perquisite compensation. If by ESG, one means a small tweak to the workable equilibrium, then perhaps it will work. If by ESG, one means diverting corporate surplus from shareholders to managers in the form of social status, then perhaps it will not.[206]

206. Sweat, *supra* note 130.