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## LEGAL STRATEGIES TO ADDRESS CAPITALISM INEQUALITIES

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## I. INTRODUCTION

America is recognized as the global icon of capitalism. Without a question, this market system has enabled the American economy to grow over the previous few decades and to enhance the economic and social circumstances of its citizens. However, if the system's weaknesses have been concealed for years, attempting to refute evidence until it became untenable, the long-term consequences are now evident and cannot be ignored. Labor's share of income continues to decline daily, and various studies reveal the dramatic impact on the totality of American society<sup>1</sup>. There has been little or no real income growth for most of American citizens in the last decades, while income gap between social classes is about as high as ever and the wealth gap in the highest since the late 1930s.<sup>2</sup> Wealth is becoming increasingly concentrated in the hands of a small group of people. All of this translates into a dilemma of chances and risks for the population's weaker segments: it's a threat to women, African American minority, and future generations<sup>3</sup>, and many others<sup>4</sup>.

As a result, the situation is becoming untenable, and public opinion is growing loud in demanding their rights<sup>5</sup>. Since 2018, a succession of contentious discussions has consumed America, including all facets of economics. The objective of this thesis is to explore and explain the many reforms and proposals made in recent years in an effort to transform capitalism into a more democratic and fairer model.

My analysis begins in Chapter II with a look at recent political reactions to growing calls for fairer working conditions. Between 2018 and 2019, Senator Elizabeth Warren and Senator Bernie Sanders introduced two measures in Congress, the Accountable Capitalism

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<sup>1</sup> See Ray Dalio, *Why and How Capitalism Needs to Be Reformed*, Harv. L. School Forum on Corp. Gov. & Fin. Reg. (October 13, 2020) see <https://corpgov.law.harvard.edu/2020/10/13/why-and-how-capitalism-needs-to-be-reformed/>

<sup>2</sup> *Id.*

<sup>3</sup> The research cited above demonstrates the domino effect of these conditions: low incomes, underfunded schools, and inadequate family support for children result in low academic success, which results in low productivity and low earnings for individuals who become economic burdens on society.

<sup>4</sup> See, e.g., Michael W. L. Elsby, Bart Hobijn & Aysegul Sahin, *The Decline of the U.S. Labor Share*, (Fed. Reserve Bank Of San Francisco, Working Paper 2013-27) Available at <https://www.frbsf.org/economic-research/files/wp2013-27.pdf> [hereinafter: Michael Elsby, *The Decline of the U.S. Labor Share*] ; see Strine, *infra* note 14; see Befort, *infra* note 16

<sup>5</sup> See, e.g., Bartley, *infra* note 30

Act<sup>6</sup> and the Reward Work Act<sup>7</sup>, to effect radical changes. The plans are very similar; both sought to incorporate German style into the American system by reducing codetermination and allocating 40% and 35% of a company's board seats to employees, respectively<sup>8</sup>. Among the other measures are the introduction - or rather, reintroduction - of corporate charters for very big corporations, as well as a restriction on stock buybacks<sup>9</sup>. Both bills have not been enacted. Both bills failed to pass, which was predictable given the system's major problems, which academics soon recognized. However, it was the first significant indication of awareness on the part of the American political class, or at the very least the democratic party.

Part III begins with the new letter from Larry Fink, CEO of Blackrock, to the CEOs<sup>10</sup>, and the new statement from the Business Roundtable<sup>11</sup>, both of which revisit the business purpose and share a common perspective: a company's purpose is no longer to maximize shareholder profit, but to care for a much broader range of stakeholders, including its employees, suppliers, customers, and the environment. Following the publication of these fresh letters, an avalanche of further remarks by opponents of shareholder primacy began.<sup>12</sup> Thus, the question remains: are these just words in the wind, or is this the foundation of a revolution? Kent Greenfield's eloquent approach to the subject is instructive: in recreating the history of corporation law in his book "*The Failure of Corporate Purpose*,"<sup>13</sup> he reminds us why, in nineteenth-century England, the crown guaranteed firms "special charters." They were in reality designed to serve a *quasi-public* role, and hence today's view, which reduces a company to a simple "nexus of contracts", that is, to a strictly private issue, overlooks their intrinsic character<sup>14</sup>. Corporate law should be considered as a branch of public law, not private, as it is assumed today. Only once this erroneous perception is corrected will we be able to really examine the business objective.<sup>15</sup>

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<sup>6</sup> Accountable Capitalism Act, S.3348, 115<sup>th</sup> Cong. (2018). <https://www.congress.gov/bill/116th-congress/senate-bill/3215?q=%7B%22search%22%3A%5B%22accountable+capitalism+act%22%5D%7D&s=1&r=1>

<sup>7</sup> Reward Work Act, S.2605, 115<sup>th</sup> Congress, (2018) <https://www.congress.gov/bill/115th-congress/senate-bill/2605/text>

<sup>8</sup> *Id.*; see ACCOUNTABLE CAPITALISM ACT, *supra* note 6

<sup>9</sup> *Id.*

<sup>10</sup> LARRY FINK, PROFITS & PURPOSE, BLACKROCK (2019) <https://www.blackrock.com/americas-off-shore/en/2019-larry-fink-ceo-letter> [hereinafter: LARRY FINK, PROFITS&PURPOSE]

<sup>11</sup> See BUSINESS ROUNDTABLE'S STATEMENT OF CORPORATE GOVERNANCE, *infra* note 76

<sup>12</sup> See *infra* notes 80-87

<sup>13</sup> See KENT GREENFIELD, THE FAILURE OF CORPORATE LAW, *infra* note 115

<sup>14</sup> *Id.*

<sup>15</sup> *Id.* at 75

Given that the emphasis has switched in recent times away from the theoretical debate of corporate purpose and toward the ESG problem - which is a subset of corporate purpose - Part IV briefly discusses the beginnings of this new trend before delving into the phenomenon of the Woke CEO<sup>16</sup>. Indeed, some senior executives in the United States are expressing their devotion to the public good by taking prominent positions on very sensitive policy matters. As you may expect, there were plenty of disagreements between supporters and doubters who fought over the sound of pieces in renowned periodicals. Finally, but certainly not least, the matter of Georgia's new election legislation provided fertile ground for clashes between corporate CEOs and American federalists, who saw their change adopted in Atlanta in March<sup>17</sup>.

In Part V, I discuss the roots of "shareholderism" and why it became the credo of American capitalism<sup>18</sup>. In exploring the doctrine's roots, I used Kent Greenfield's "historical exercise" to ascertain the doctrine's initial nature. Thus, I will argue that even in this instance, corporations' quasi-public role resurfaces. The concept of shareholder primacy was not always so rotten. His disease arises from frustration with the quest for a new system of corporate governance in order to remain ahead of the changes brought about by globalization in the second part of the twentieth century. At this point, two conflicting schools of thought emerge: one thinks that shareholder primacy is the highest virtue; the other argues that it is the primary source of today's society's ills. Scholars are pushing for a change and numerous options have been considered<sup>19</sup>: Some opponents stated that it is sufficient to create a new framework for corporate governance with the eventual objective of including the interests of non-shareholders, or Stakeholders, within the spectrum of directors' responsibilities<sup>20</sup>. Others advocate for substantial legislative reforms, arguing that capitalism's issues are too complex and that such reforms are difficult to achieve without the assistance of law: the ability to punish misbehavior is critical<sup>21</sup>.

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<sup>16</sup> See Elliot Kaufman, "Woke" CEOs, *infra* note 139.

<sup>17</sup> See JAMES QUINCEY, STATEMENT FROM JAMES QUINCEY GEORGIA VOTING LEGISLATION, (April 1, 2021) see <https://www.coca-colacompany.com/media-center/georgia-voting-legislation>

<sup>18</sup> See, e.g., Adi Ignatius, *Are We Giving Shareholders Too Much Power?* 2017 HARV. B. REV., May, Available at: <https://hbr.org/2017/05/are-we-giving-shareholders-too-much-power>

<sup>19</sup> See, e.g., Joseph L. Bower and Lynn S. Paine, *The Error at the Heart of Corporate Leadership*, 2017 HARV. B. REV. (May-June 2017) pp. 50-60 <https://hbr.org/2017/05/the-error-at-the-heart-of-corporate-leadership>

<sup>20</sup> See, e.g., Martin Lipton, Steven Rosenblum and William Wachtell, *On the Purpose and Objective of the Corporation*, *infra* note 95.

<sup>21</sup> See, e.g. KENT GREENFIELD, NEW PRINCIPLES FOR CORPORATE LAW (2005)

## II. RADICAL REFORM BILLS

### A. *Rising disparities in America*

In portraying the postwar business and its socio-political context, “*one of the most prominent public policy intellectuals of the Twentieth Century*”<sup>22</sup>, Adolf Berle, claimed that private companies and the government had reached a secure balance after the New Deal: corporations were driven by profits and policed their own actions to prevent radical interference by post-New Deal governments<sup>23</sup>. In other words, corporate self-restraint enabled the federal government to control corporate powers by threatening restrictions rather than by taking intrusive (and politically divisive) affirmative actions. The government's undisputed economic management dominance, as well as a strong commitment to pursuing full employment and a stable, fair distribution of economic benefits, brought managers to heel as “*quasi-public servants*”<sup>24</sup>. During those years, shareholders were perceived as either passive dividend collectors or philanthropists, with no specific interest to become involved into corporate management<sup>25</sup>.

But fractures in the stability started in the 1970s<sup>26</sup>. The recession, together with financial market collapse, oil shocks, and intensified global competition in manufacturing, all dealt the economy a serious blow. The political alliance that prospered in the New Deal was disintegrated, and the regulatory state failed to keep pace with new opportunities for risk-

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<sup>22</sup> Accountable Capitalism Act, S.3348, 115<sup>th</sup> Cong. (2018). <https://www.congress.gov/bills/116/congress/senate/bills/3215?q=%7B%22search%22%3A%5B%22accountable+capitalism+act%22%5D%7D&s=1&r=1>

<sup>23</sup> See William Wilson Bratton, *The Separation of Corporate Law and Social Welfare* (2017). 74 WASHINGTON AND LEE LAW REVIEW, p. 767, 2017, (U of Penn, Inst for Law & Econ Research Paper No. 17-10), (European Corporate Governance Institute (ECGI) - Law Working Paper No. 357/2017), [hereinafter: William Bratton, *The Separation of Corporate Law and Social Welfare*]

<sup>24</sup> *Id.* at 771

<sup>25</sup> *Id.* at 773-74

<sup>26</sup> See KATHY STONE, *The Labor System of the Industrial Era*, in FROM WIDGETS TO DIGITS: EMPLOYMENT REGULATION FOR THE CHANGING WORKPLACE 27, 43-44 (2004)

taking and corporate externalization<sup>27</sup>. Good-faith administrative engagement with current laws devolved into minimum legal enforcement as threats of regulatory interference faded. Milton Friedman's groundbreaking essay "*The Social Responsibility of Business is to Increase its Profits*" aptly represents the emerging new conception of the corporation's social role<sup>28</sup>, which enhanced concerns over the resurgence of management risk-taking and profit-seeking that served to fuel corporate governance and social responsibility movements. In addition, some critics underline that the establishment of the "Shareholder primacy" doctrine was supported by a string of hostile takeovers in the 1980s, which resulted in buyouts and drastic "restructuring"<sup>29</sup>. Executives started to comply with stockholders' request only, to avoid removal from the board and, as a result, the ultimate corporate priority became maximization of shareholder equity, while self-serving directors were viewed as roadblocks<sup>30</sup>. That is why stockholders' ability to demand corporate policies that benefit their interests has skyrocketed, while working people's clout in the corporate power system has plummeted. This pattern has resulted in large American corporations devoting 93 percent of their profits to shareholders over the last decade, diverting trillions of dollars that could have gone to jobs or long-term investments<sup>31</sup>. As a result, stockholders have gotten a bigger piece of the pie, while employees have been left with crumbs.<sup>32</sup> Since shareholder value maximization began, indeed, job productivity has risen gradually, but average worker's real revenue has essentially stagnated, and the share of national income going to workers has fallen sharply. Workers lose regulatory safety and job security as their careers

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<sup>27</sup> See William Bratton, *The Separation of Corporate Law and Social Welfare*, *supra* note 23, at 771-72

<sup>28</sup> See MILTON FRIEDMAN, *The Social Responsibility of Business is to Increase its Profits*, N.Y. TIMES MAG., (Sept. 13, 1970) Section 6 (Magazine) 32 at 33. In the paper Friedman harshly criticized those in the business community who maintained that private enterprises had a mission to promote desirable social ends. [hereinafter: Milton Friedman, *The social responsibility of Business*]

<sup>29</sup> often a euphemism for cost-cutting layoffs

<sup>30</sup> See CAREW S. BARTLEY, *The Accountable Capitalism Act in Context and Its Implications for Legal Ethics*, J.D. GEORGETOWN UNIVERSITY LAW CENTER (May 2021) available at <https://www.law.georgetown.edu/legal-ethics-journal/wp-content/uploads/sites/24/2020/09/GT-GJLE200014.pdf> [hereinafter: CAREW BARTLEY, *The Accountable Capitalism Act in Context*]

<sup>31</sup> See Leo E. Strine, Kovvali, Aneil and Williams, Oluwatomi, *Lifting Labor's Voice: A Principled Path Toward Greater Worker Voice And Power Within American Corporate Governance* (February 24, 2021). U of Penn, Inst for Law & Econ Research Paper No. 21-09, Columbia Law and Economics Working Paper No. 643, Minnesota Law Review, Forthcoming, Available at SSRN: <https://ssrn.com/abstract=3792492> [hereinafter: Leo Strine, *Lifting Labor's Voice*]

<sup>32</sup> *Id.*

are reduced to jobs and gigs (short-term, outsourced work contracts)<sup>33</sup>. Health benefits and pensions are being phased out<sup>34</sup>. Inequalities are expanding as labor's prospects and security dwindle, while executive pay increases, due also to equity arrangements that link executive earning to stock price. Moreover, Corporations have reduced jobs in the United States while growing outsourcing. All of these factors are converging to the disappearance of the middle class<sup>35</sup>.

As professor William W. Bratton states in his paper "*The Separation of Corporate Law and Social Welfare*" "*It is now clear that the market side really won the battle of the 1980s, succeeding in entering a wedge between corporate law and social welfare.*"<sup>36</sup> Activists for workers and other stakeholders are therefore calling for internal legislation in the form of changes to corporate and securities regulations that force companies to give more weight to their priorities. In 2011, the Occupy Wall Street protests in New York City's financial district reflected a surge of public outrage against corporate corruption and income inequality<sup>37</sup>.

## *B. Recent Political responses*

As a result of these developments, recent political responses have sought to resolve these concerns in an effort to reinvent corporate governance.

### *1. The Accountable Capitalism Act*

Massachusetts' Senator Elizabeth Warren, a "*leading progressive voice, pushing for major systemic reform that will improve our economy and restore the middle class*"<sup>38</sup> introduced in 2018 the Accountable Capitalism Act (ACA) in Congress.<sup>39</sup> The aim of the bill was to

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<sup>33</sup> *Id.* at 782; see Stephen F. Befort, *The Declining Fortunes of American Workers*, 70 FLA. L. REV. 189, 191–96 (2018) (discussing decreased workforce attachment).

<sup>34</sup> *Id.* at 783

<sup>35</sup> *Id.* at 783–84

<sup>36</sup> *Id.* at 768 & n.4

<sup>37</sup> See CAREW BARTLEY, *The Accountable Capitalism Act in Context*, *supra* note 30 (citing Heather Gautney, *What is Occupy Wall Street? The History of Leaderless Movements*, WASH. POST (Oct. 10, 2011), [https://www.washingtonpost.com/national/on-leadership/what-is-occupy-wall-street-the-history-of-leaderless-movements/2011/10/10/gIQAwkFjaL\\_story.html](https://www.washingtonpost.com/national/on-leadership/what-is-occupy-wall-street-the-history-of-leaderless-movements/2011/10/10/gIQAwkFjaL_story.html) [ <https://perma.cc/CF42-TPA6> ]

<sup>38</sup> *About Elizabeth Warren*, OFFICE OF SEN. ELIZABETH WARREN (Sept. 5, 2013)

<sup>39</sup> See ACCOUNTABLE CAPITALISM ACT, *supra* note 6



*“achieve a federal ‘reorientation’ of corporate law and corporate governance in particular”*<sup>40</sup> but sparked significant controversies and polarized public opinion. Indeed, even though the reform was written with the most honorable of intentions, it failed to pass, with opponents claiming that the bill would *“have a number of not-so-welcome consequences no doubt unintended”*<sup>41</sup>.

To begin, the Act includes a provision requiring all companies with more than \$1million in revenue to obtain a federal corporate charter from the newly created Office on United States Corporations<sup>42</sup>. A federal corporate charter is not a novel idea. Consider the early days of American corporate law, in nineteenth century, when federal corporate charters, granted by state legislature through the passing of private, individual and tailored legislations, were required to form any business organization.<sup>43</sup> What is creating complications in this provision for companies to obtain the federal approval, according to Milton Ezrati, is states’ exclusion for the whole procedure<sup>44</sup>. The effect would seem to *“trample federalist notions on which the country has operated since its founding”*<sup>45</sup>, and as a result, many states would undoubtedly oppose to it, such as Delaware<sup>46</sup>, which has made a business out of granting corporate charters<sup>47</sup>.

Even though, it would be unlikely that Senator Warren’s reform *“ever constituted a significant threat to Delaware’s dominance”* because *“it is uncertain whether a statute that requires large companies to obtain a federal charter as an additional chart can cause a meaningful erosion of state corporate law”*<sup>48</sup>, concludes Prof. Matera.

What’s more is that such charter could have been revoked if the corporation engaged in criminal activities. In this regard, experts’ voices who have sided against the ACA, argued that State attorneys general already have the authority to revoke a corporation’s license or registration. As a result, this question seems to be already addressed, and the ACA’s

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<sup>40</sup> See Pierluigi Matera, *Delaware’s Dominance, Wyoming’s Dare. New Challenges, Same Outcome?*, 27(1) Fordham Journal of Corporate & Financial Law *forthcoming* 2021, <https://ssrn.com/abstract=3763106> . (In his paper Prof. Matera argues Delaware’s dominance with respect to the ACA if it was passed)

<sup>41</sup> See Milton Ezrati, *Senator Warren’s Accountable Capitalism Bill Has Big Problems*, FORBES (Feb 5, 2019) <https://www.forbes.com/sites/miltonezrati/2019/02/05/senator-warrens-accountable-capitalism-bill-has-big-problems/?sh=2869cde6471b> [hereinafter: Milton Ezrati, *Senator Warren’s Bill*]

<sup>42</sup> See Accountable Capitalism Act, *supra* note 6 at §4(a)(1).

<sup>43</sup> See GREENFIELD, THE FAILURE OF CORPORATE LAW *supra* note 115.

<sup>44</sup> See Milton Ezrati, *supra* 41

<sup>45</sup> Pierluigi matera, *Delaware’s Dominance*, *supra* note 40

<sup>46</sup> *Id.*

<sup>47</sup> *Id.*

<sup>48</sup> *Id.*

provision is rendered ineffective<sup>49</sup>. Notably, corporations in the United States would be liable for injunctive relief rather than punitive penalties if they refuse to “*pursue or produce a general public benefit*”<sup>50</sup> which undermines the reform’s general meaning: if no duty exists, why should corporations undergo such drastic changes?

Additionally, Sen. Warren states in the Official ACA document that a U.S. corporation should have “*the purpose of creating a general public benefit, meaning a material positive impact on society resulting from its business operations*”.<sup>51</sup> Its board of directors is therefore responsible for achieving these benefits, since it must “*consider the effects of any action or inaction on the interests of all corporate stakeholders, including employees, customers, shareholders, the communities in which the company operates, and the environment*”, which is extremely appealing, but opposing claims underline that the bill contains no instruction on how to do so.<sup>52</sup> In light of companies’ fear to lose their charters if breaching the laws, it would be essential for them to adopt a mechanism to resolve conflicts which is approved by interested parties<sup>53</sup>. If corporate executives were left to their own devices, there would be no end to stakeholder lawsuits. If the authority to adjudicate is vested in a federal bureau, questions will arise over who is in charge of the corporation: the elected directors, the management, or the United States government<sup>54</sup>.

Going ahead, one of the most contentious aspect of the *Accountable Capitalism Act* is the requirement that 40 percent of corporation’s board of directors be elected by its employees<sup>55</sup>, thus integrating German legal principles into American corporate law. The debate in this regard has been even more ambiguous. Senator Warren’s grounds for the proposal were “*the successful strategy in Germany and other developing economies*”<sup>56</sup> - which was not hard to envision- because she believes employees’ perspective can contribute to have a diversified — hence more balanced- board. Two main observations serve as opposition in the debates<sup>57</sup>. First, criticism pointed out that workers’ empowerment can actually

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<sup>49</sup> See Denise Kuprionis, *Will Warren’s Accountable Capitalism Act Help? The Answer is No*, Har. L. School Forum on Corporate Gov. & Fin. Reg. (September 10, 2018). <https://corpgov.law.harvard.edu/2018/09/10/will-warrens-accountable-capitalism-act-help-the-answer-is-no/>

<sup>50</sup> ACCOUNTABLE CAPITALISM ACT, *See supra* note 6

<sup>51</sup> *Id.* at §5(b)(2)

<sup>52</sup> *Id.*

<sup>53</sup> See Milton Ezrati, *Senator Warren’s Bill*, *supra* note 41

<sup>54</sup> *Id.*

<sup>55</sup> *Id.*

<sup>56</sup> See Accountable Capitalism Act One-Pager, OFFICE OF SENATOR ELIZABETH WARREN (2018), <https://www.warren.senate.gov/imo/media/doc/Accountable%20Capitalism%20Act%20One-Pager.pdf> [https://perma.cc/SC4J-7APR].

<sup>57</sup> *Id.*

exacerbate the situation by having a more limited and short-term view of the company's future<sup>58</sup>; secondly, as Prof. Leo Strine argues in his recent paper "*Lifting Labor's Voice: A Principled Path Toward Greater Worker Voice And Power Within American Corporate Governance*"<sup>59</sup>, in the countries where codetermination is used, there is a consistent coordination between the companies' internal structure - through which management and labor must collaborate to regulate business in a way that benefits stakeholder too - and external regulations, that affirm the need for businesses to handle employees equally and offer extra assistance to those who need it<sup>60</sup>. Coordination that is lacking in America. That is why, due to American peculiarities in areas such as executive boards and collective bargaining, exact comparison to and wholesale adoption of German or other European models can be challenging and misleading.

## 2. *The Reward Work Act*

However, the Accountable Capitalism Act, was not the first one to incorporate the notion of "*workers empowerment*"<sup>61</sup>. Bernie Sanders, a political outsider and democratic socialist, crossed similar roads, ushering into the political mainstream progressive policies to address income inequalities, better healthcare, and free higher education. He attempted to accomplish this with his Reward Work Act<sup>62</sup> which he introduced in collaboration with Senators Tammy Baldwin, Elizabeth Warren, and Brian Schatz. The bill would allow employees to actively vote one-third of their corporations' management<sup>63</sup>. The scope of implementation of the plan differs from the ACA because it applies to all publicly owned companies of any size, as well as all privately held businesses with annual revenue of at least \$100 million, totaling 3,437 companies.<sup>64</sup>

The proponents of the initiative argued that anyone trying to defend the democracy from disproportionately centralized corporate control should take codetermination seriously, as

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<sup>58</sup>See Milton Ezrati, *Senator Warren's Bill Has Big Problems*, *supra* note 41

<sup>59</sup> See Leo Strine, *Lifting Labor's Voice*, *supra* note 31

<sup>60</sup> *Id.*

<sup>61</sup> See Senator Tammyn Baldwin, *Reward Work Not Wealth* ( March 22, 2018) available at <https://www.baldwin.senate.gov/imo/media/doc/Reward%20Work%20Not%20Wealth%20Baldwin%20Staff%20Report%203.26.19.pdf>

<sup>62</sup> See Reward Work Act, *supra* note 7

<sup>63</sup> *Id.*

<sup>64</sup> *Id.*

it has the potential to enhance democracy in corporate law on three fronts: first, they explain “the attraction of codetermination as a mechanism to protect the democratic state is that can be adopted preventively and thereby avert dangers before they materialize”<sup>65</sup>. Secondly, by providing employees with a credible and accepted firm-level mechanism for voicing grievances outside of democratic elections, codetermination reduces the pressure for political populism. Finally, codetermination will support economies cope with exogenous shocks such as the COVID-19 pandemic by providing a mechanism for business and workers to organize their conduct<sup>66</sup>. However, they make no argument that implementing such policies will be inexpensive, let alone improve economic efficiency<sup>67</sup>. On the other hand, the arguments cited above (such as those of Prof. Leo Strine<sup>68</sup>) in opposition to the ACA’s codetermination can also be applied to the problem at hand. Would implementing codetermination, and thereby increasing in employees’ power, benefit or hurt the corporation’s long-term perspective? The discussion does not seem to have concluded yet.

Alongside with introducing codetermination, the Bill’s second purpose was to address the problem of stock buybacks, which was brought to light by William Lazonick’s award-winning essay “*Profits Without Prosperity: Stock Buybacks Manipulate the Market and Leave Most Americans Worse Off*”<sup>69</sup>. The paper attributes stock buybacks to the escalation of income inequality in the United States and deterioration of the middle class. It’s worth noting, however, that while Professor Lazonick concludes his paper by saying that “*If America wants an economy in which corporate profits result in shared prosperity, the buy-back and executive compensation binges will have to end*”<sup>70</sup>; he also asserts that not all

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<sup>65</sup> See Jens Dammann and Horst Eidenmueller G. M., *Codetermination and the Democratic State*. UNI. OF ILLINOIS L. REV., (Forthcoming), (Europ. Corp. Gov. Institute L. Working Paper, Paper No. 536/2020). Available at SSRN: <https://ssrn.com/abstract=3680769> or <http://dx.doi.org/10.2139/ssrn.3680769> (discussing implementation of codetermination in American system)

<sup>66</sup> *Id.*

<sup>67</sup> *Id.*

<sup>68</sup> See Leo Strine, *Lifting Labor’s Voice*, *supra* note 31

<sup>69</sup> See William Lazonick, “*Profits Without Prosperity: Stock Buybacks Manipulate the Market and Leave Most Americans Worse Off*”, HARV. B. REV., Sept.-Oct. 2014 See <https://hbr.org/2014/09/profits-without-prosperity?autocomplete=true> In this paper prof. Lazonick argues that despite high corporate earnings and thriving stock market, most Americans are not benefiting from the economic revival. While the top 0.1 percent of earners enjoy nearly all of the benefits, good jobs keep vanishing, and new ones are insecure and underpaid. One of the major causes is that instead of spending profits in growth opportunities, companies are repurchasing their own stocks. This left no money to invest in profitable capabilities or raise worker wages. Why are vast majority of money devoted to stock buybacks? Since equity-based compensation accounts for the bulk of executive compensation, and buybacks boost short-term stock prices. Buybacks play a significant role in soaring executives’ pay and income injustice. Their excessive usage destabilizes the economy because they harvest value rather than produce it. According to him, government and business leaders must take measures to rein them in in order to return true prosperity to the world. [hereinafter: William Lazonick, *Profits without prosperity*]

<sup>70</sup> *Id.*

buybacks are dangerous for the financial system. Tender offers made by executives with significant equity stakes in order to take advantage of a lower stock price to consolidate ownership in their own hands benefit long-term competitiveness. In this case, a company contacts shareholders and offers to buy back their shares at a specific near-term date, after which shareholders who agree with the price tender their shares to the company. Warren Buffet, for example, was notorious for using tender offers<sup>71</sup> at GEICO<sup>72</sup>.

However, Prof. Lazonick argues that tender offers accounts for a small fraction of modern buybacks. A significant portion of them is now conducted on the free market, affecting investment possibilities in profitable capacities, resulting in losses to long-term shareholders. As a further proof of the issue's significance, Larry Fink, chairman and CEO of BlackRock, the world's largest wealth manager, said: "*it concerns us that, in the wake of the financial crisis, many companies have shied away from investing in the future growth of their companies*"<sup>73</sup>. And the statistics were self-explanatory: In 1981, the S&P 500 invested almost 2 percent of its earnings on stock buybacks. Nevertheless, in 2017, the same firms spent 59 percent of their earnings on stock buybacks. With stock-based compensation accounting for 82 percent of executives compensation, CEOs have a direct incentive to increase premiums<sup>74</sup>. To address these concerns, the Reward Work Act would repeal Securities and Exchange Commission Rule 10b-18, essentially prohibiting companies from repurchasing stocks on the open market<sup>75</sup>. It is self-evident that America's economic stability or vulnerability is determined by the system by which corporate capital is distributed. Rather than that, it is far clearer that buyback and executive pay binges must come to an end if we are to develop a just model of society<sup>76</sup>.

From the end of Great Depression until the 1980s, the New and Fair Deal paradigms allowed America's economy to expand steadily, prosperously, and widely shared. This was changed in the 1980s by the philosophy of 'Greed Is Nice'. Since then, the distribution of the rewards of global growth has shifted dramatically<sup>77</sup>.

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<sup>71</sup> As Buffett highlighted, this kind of tender offer should be issued when the share price is less than the inherent worth of the firm's productive capacities and the firm is profitable enough to buy the shares without jeopardizing future investment plans.

<sup>72</sup> See Milton Ezrati, *Senator Warren's Bill Has Big Problems*, *supra* note 58

<sup>73</sup> See LARRY FINK, PROFITS&PURPOSE, *supra* note 10

<sup>74</sup> See REWARD WORK NOT WEALTH, OFFICE OF TAMMY BALDWIN (March 27, 2019) Available at: <https://www.baldwin.senate.gov/imo/media/doc/Reward%20Work%20Not%20Wealth%20Baldwin%20Staff%20Report%203.26.19.pdf>

<sup>75</sup> See REWARD WORK ACT, *supra* note 7§ 4 (c)

<sup>76</sup> See William Lazonick, *Profits Without Prosperity*, *supra* note 69

<sup>77</sup> See Bratton, *The Separation of Corporate Law and Social Welfare*, *supra* note 23

As a result, while the American capitalist system has established itself as a "perfect machine" in terms of productivity and growth since the 1980s, the time has come to transform it into a machine that is not only efficient but also just. Everyone will acknowledge that working conditions in the United States of America should be changed. American jobs, once again, or worse, take focus away from internal and external changes that are more realistic within our economic structure and thus more likely to result in greater economic progress for workers. The Accountable Capitalism Act and the Reward Work Act, proposed by Senators Warren and Sanders, respectively, may not have been well thought out, but their proposal serves as a reminder that a company's first—and sometimes only—priority is a relatively new concept. As such, they should be applauded for attempting to provide a concrete solution to a structure in desperate need of reform.

Furthermore, despite the Bills' failure, the initiative underlying them has garnered widespread support, even from the federalist camp. According to Civis Analytics' survey<sup>78</sup>, those who identify as "lean Democrat" voted 75% in favor of the issue, with just 9% voting against it<sup>79</sup>. Around 43% of those classified as "lean Republicans" supported the proposal, while 31% opposed it. Although the manner in which they are applied can elicit varying opinions, the underlying principles have proven to be extremely common.

### III. DEBATE ON CORPORATE PURPOSE

#### *A. Change of route*

The amendments listed above were the result of a broader discussion, which is also one of the oldest in American and international corporate law: What is the real purpose of a corporation? For Whom is a corporation managed?<sup>80</sup> Politicians, CEOs, lawyers, as well as

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<sup>78</sup> Civis is a Democratic data firm. <https://www.civisanalytics.com/>

<sup>79</sup> The following question was posed to a sample of 3,300 Americans: In many countries, workers of big corporations elect members to the board of directors to represent their interests and points of view to management. Democrats argue that this provides ordinary people a larger voice in how their businesses are managed and hence increases salaries, while Republicans argue that it reduces business efficiency and is thus detrimental to the economy. Would you favor allowing workers of major corporations to elect representatives to the board of directors of their company?

<sup>80</sup> Edward B. Rock, *For Whom is the Corporation Managed in 2020?: The Debate over Corporate Purpose* (May 1, 2020). (European Corporate Governance Institute L. Working Paper, Paper No. 515/2020), (NYU School of Law, Public Law Research Paper No. 20-16), (NYU Law and Economics Research Paper), Available at

law and business professors, have all expressed their opinions, resulting in a multitude of divergent suggestions.

The latest modern controversy stems from BlackRock CEO Larry Fink's letter to CEOs in January 2018, in which he urged corporations to define and pursue a "purpose":

*"Society is demanding that companies, both public and private, serve a social purpose. To prosper over time, every company must not only deliver financial performance, but also show how it makes a positive contribution to society. Companies must benefit all of their stakeholders, including shareholders, employees, customers, and the communities in which they operate"*<sup>81</sup>

It was the first global fund manager to warn future portfolio companies that they must deliver both financial results and societal contributors or risk losing the world's largest asset manager's endorsement. Until this time, few voices of opposition were noticed, while Milton Friedman's stance, as articulated in the aforementioned paper in section II<sup>82</sup>, was widely disseminated and regarded as the rule. One of the rare exceptions to the rule has been Charles Handy's paper in which he rejects the philosophy that the unique scope of a corporation "*is to make profits, full stop*"<sup>83</sup>. Rather than that, it is to produce wealth so that company owners, their families, and those near and far "*can do what pleases them*", and that businesses should be run as families, because that is what they are!<sup>84</sup>

In 2019, Larry Fink's letter to CEOs was followed by the Business Roundtable's famous "*Statement on the Purpose of a Corporation*" which was signed by 181 CEOs<sup>85</sup>. In its declaration, the Roundtable emphasized businesses fulfill a critical role in society by providing products and services<sup>86</sup>, challenging its own 1997 Statement on Corporate Governance which argued that primary corporate goal is to "*generate economic returns to its*

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SSRN: <https://ssrn.com/abstract=3589951> or <http://dx.doi.org/10.2139/ssrn.3589951> [hereinafter: Edward Rock, *For Whom Is the Corporation Managed in 2020?*]

<sup>81</sup> <https://www.blackrock.com/corporate/investor-relations/2018-larry-fink-ceo-letter>

<sup>82</sup> See MILTON FRIEDMAN, *The Social Responsibility of Business*, *supra* note 28

<sup>83</sup> See Charles Handy, *What is a Business for?*, HARV. B. REV., (December 2002), Available at SSRN: <https://ssrn.com/abstract=932676>

<sup>84</sup> *Id.*

<sup>85</sup> BUSINESS ROUNDTABLE REDEFINES THE PURPOSE OF A CORPORATION TO PROMOTE "AN ECONOMY THAT SERVES ALL AMERICANS", (Aug 19, 2019) Available at: <https://www.business-roundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans> [hereinafter: BUSINESS ROUNDTABLE 2019]

<sup>86</sup> *Id.*

owners”<sup>87</sup>. Since then, each edition of the report has embraced shareholder primacy principles, according to which companies operate primarily to serve shareholders. The 2019 Declaration, instead, surpasses previous agreements and establishes a progressive structure for corporate accountability which is consistent with the BRT's earlier 1981 Claim on Corporate Responsibility, that acknowledged “*the long-term survival of the business sector is related to its responsibility to the community of which it is a member*” and that “*the long-term viability of the business sector is linked to its responsibility to the society of which it is a part.*”<sup>88</sup>

These assertions were not made in a vacuum. Prof. Edward Rock conducted more research into the causes of this outpouring of fury and discovered at least two interrelated strands: To begin, populism has expanded exponentially in the United States and abroad since 2008, revealing itself in a number of forms, including dissatisfaction, Brexit, and Donald Trump's election triumph in 2017. Second, and most directly related, the partisan schism in American electoral politics has resulted in deadlock in Congress<sup>89</sup>. Many individuals have lost faith in the efficacy of policies to handle social concerns such as climate change, redistribution, and poverty, to mention a few. Simultaneously, progressive regulatory remedies are being explored, despite the fact that they are now impractical to execute.<sup>90</sup>

Disappointment with regulatory inertia coupled with the danger of drastic potential legislation, has culminated in a flurry of new ideas that can be launched by private sector initiatives. This includes Lipton's “New Paradigm”<sup>91</sup> and the “Commonsense Corporate Governance Principles,”<sup>92</sup> as well as new organizations such as the “Investor Stewardship Coalition” seeking to forge a new consensus.

Numerous efforts to increase boardroom attention to “ESG” or “Environmental, Social, and Governance”<sup>93</sup> issues, such as a board-level emphasis on climate change, diversity, and human capital, are also part of the initiative to move toward a more prosperous system.

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<sup>87</sup> THE BUSINESS ROUNDTABLE, STATEMENT ON CORPORATE GOVERNANCE (September 1997) available at <http://www.ralphgomory.com/wp-content/uploads/2018/05/Business-Roundtable-1997.pdf>

<sup>88</sup> Kristin Bresnahan, The Purpose Debate Back to the 80's: Business Roundtable's “Purpose” Statement Redux, DIRECTORS&BOARD (October 22, 2020) <https://www.directorsandboards.com/articles/singlepurpose-debate-back-80s-business-roundtable-s-“purpose”-statement-redux> [hereinafter: Kristin Bresnahan, *The Purpose Debate Back to the 80's*]

<sup>89</sup> See Edward Rock, *For Whom is the Corporation Managed in 2020?*, *supra* note 80 at n.4

<sup>90</sup> *Id.*

<sup>91</sup> See Martin Lipton, Steven Rosenblum and William Wachtell, *On the Purpose and Objective of the Corporation*, *infra* note 95.

<sup>92</sup> TIM ARMOUR, MARRY BARRA, WARREN BUFFET et. al., COMMONSENSE CORPORATE GOVERNANCE PRINCIPLES 2.0 (2<sup>nd</sup> ed., 2018) <https://www.governanceprinciples.org/>

<sup>93</sup> See *infra* note 131



Thus, it is not difficult to contextualize Warren and Sander's Bills, as well as the groundbreaking pronouncement in 2018-19, considering how significantly the political and social landscape has altered in last decades.

As previously mentioned, BRT and Larry Fink's change in stance, spawned a contemporary trend for commentators and public figures to offer arguments on corporate purpose and *shareholder primacy*<sup>94</sup>. Martin Lipton, respected business lawyer, was one of them in criticizing "*shareholder primacy*" in a series of memos and articles<sup>95</sup>: while noting that for-profit companies do not operate merely to generate profits for shareholders, he describes long-term profitability as the basic purpose of ethical behavior, requiring all company organizations to share and apply the existing declaration of corporate intent, as well as clear action and communication guidelines<sup>96</sup>.

And, once again, Colin Mayer, a renewed Oxford finance economist and former dean of the Oxford Said School of Business, has pointed the finger at it in two recent books, *Prosperity: Better Business Makes the Greater Good*<sup>97</sup>(2018) and *Firm Commitment* (2019)<sup>98</sup>. He contends that in order to render capitalism "sustainable", a legislative framework must be developed that encourages alignment of corporate activities with social goals and assures that corporations' ownership, administration, measurement, and reward systems are

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<sup>94</sup> See *infra*, Part V A (discussing shareholder primacy)

<sup>95</sup> See Martin Lipton, Steven A. Rosenblum, and William Savitt, Wachtell, Lipton, Rosen & Katz, *On the Purpose and Objective of the Corporation*; 2020 Harv. L. School Forum On Cor. & Gov. & Fin. Reg., <https://corpgov.law.harvard.edu/2020/08/05/on-the-purpose-and-objective-of-the-corporation/> [hereinafter: Martin Lipton, Steven Rosenblum and William Wachtell, *On the Purpose and Objective of the Corporation*] In redefining their view of Corporate Purpose and objectives, they argued arguing

"The purpose of a corporation is to conduct a lawful, ethical, profitable and sustainable business in order to ensure its success and grow its value over the long term. This requires consideration of all the stakeholders that are critical to its success (shareholders, employees, customers, suppliers and communities), as a determinant by the corporation and its board of directors using their business judgment and with regular engagement with shareholders, who are essential partners in support the corporation's pursuit of its purpose".

<sup>96</sup> *Id.*

<sup>97</sup> COLIN MAYER, *PROSPERITY: BETTER BUSINESS MAKES THE GREATER GOOD* (2018) (discussing corporate purpose) [hereinafter: MAYER, *PROSPERITY*]

<sup>98</sup> COLIN MAYER, *FIRM COMMITMENT* (2019). In his books he also considers as the best concrete solution to the "malaise" include lofty mission statements in corporation's article of association. Instead of being a series of laws, corporate law will become a "dedication device". Even, for many executives grappling with the new company's diverse goals, Milton Friedman's similarly simplistic doctrine – that business's one and only social duty is to maximize profitability under the rules of the market – is bound to appeal. [hereinafter: MAYER, *FIRM COMMITMENT*]

aligned with these goals<sup>99</sup>. Similarly, “shareholder primacy” is irreconcilable with the need for firms to adequately address both climate change and economic inequality.<sup>100 101</sup>

### *B. Between Propaganda and Reality*

“For a company to be profitable, long-lasting, and return value to shareholders, it must respect the needs and satisfy the equal demands of a broad variety of stakeholders, including consumers, staff, and the communities in which it operates”<sup>102</sup> the declaration reads in part. However, the discussion quickly switched to the pursuit of factual work for this novel theoretical perspective. Were any steps taken in response to the words? Was any concrete action done in response to the allegations? To begin, the 2019 declaration elicited both anticipation and pessimism. Supporters underlined the importance of the corporation's economic performance being dependent on its interactions with a wide collection of stakeholders who contribute to its success<sup>103</sup>. On the other side, the general consensus is that the remarks were all front, with little substance behind them<sup>104</sup>. Nancy Koehn, an historian at Harvard Business School, offers a personal perspective that encapsulates the majority of skeptics: “They’re reacting to something in the zeitgeist,” she said. “They believe that business as usual is no longer acceptable and it is unclear if any of these corporations will alter their business practices.”<sup>105</sup>

Some scholars, indeed, were plainly dubious since a real revolution would rely on how precisely and quantifiably each CEO outlines his or her stakeholder objectives, and

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<sup>99</sup> See MAYER, PROSPERITY, *supra* note 99; see also MAYER, FIRM COMMITMENT, *supra* note 98

<sup>100</sup> *Id.*

<sup>101</sup> See Martin Lipton, Wachtell, Lipton; Rosen & Katz, *It’s Time to Adopt the New Paradigm*, Harv. L. School Forum on Cor. Gov. & Fin. Reg., (February 11, 2019) available at <https://corpgov.law.harvard.edu/2019/02/11/its-time-to-adopt-the-new-paradigm/>

<sup>102</sup> BUSINESS ROUNDTABLE, BUSINESS ROUNDTABLE REDEFINES THE PURPOSE OF A CORPORATION TO PROMOTE “AN ECONOMY THAT SERVES ALL AMERICANS” (Aug 19, 2019) [hereinafter: BUSINESS ROUNDTABLE] <https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans>

<sup>103</sup> See, e.g., Sanjai Bhagat & R. Glenn Hubbard, Should the Modern Corporation Maximize Shareholder Value? 2020 CLS BLUE SKY BLOG <https://clsbluesky.law.columbia.edu/2020/08/12/the-false-dichotomy-of-corporate-governance-platitudes/>

<sup>104</sup> Nell Minow, *Six Reasons We Don’t Trust the New “Stakeholder” Promise from the Business Roundtable*, 2019 Harv. L. School Forum On Cor. Gov. & Fin. Reg. <https://corpgov.law.harvard.edu/2019/09/02/six-reasons-we-dont-trust-the-new-stakeholder-promise-from-the-business-roundtable/> [hereinafter: Nell Minow, Six Reasons We don’t trust “Stakeholder” Promise]

<sup>105</sup> Interview with Nancy Kohen, Historian at Har. B. School (2019) .N. Y. TIMES ; See David Gelles and David Yaffee-Bellany, “Shareholder Value Is No Longer Everything, Top CEOs Say”, N. Y. TIMES (August 9, 2019) available at <https://www.nytimes.com/2019/08/19/business/business-roundtable-ceos-corporations.html>

particularly on how their remuneration is linked to those objectives<sup>106</sup>. If compensation continues to be solely or mostly determined by stock price, this remark is only a diversion<sup>107</sup>. Indeed, there was no reference to CEO remuneration at the Roundtable, a hot subject given that the top 100 chief executives earn 254 times the wage of the ordinary employee at their corporation<sup>108</sup>.

While moderate viewpoints, such as those advanced by Andrew Winston, suggest that some of these CEOs really believe what they say and really want to find a new purpose, yet the primary barrier is that taking stakeholder concerns seriously still entails significant transformation<sup>109</sup>. In a recent article he cites the burning of the Amazon as an example, which is primarily the result of policies promoting industrial agriculture and the meat industry, both of which were permitted by a Brazilian president seeking to monetize natural wealth. He underlines that companies who sign a declaration like the BRT's one, should refrain from purchasing beef from suppliers that burn down the Amazon to develop grazing grounds. And business that actually prioritize stakeholders and long-term needs before short-term profits would aggressively oppose this kind of destructive regulation. Similarly, signatories should become outspoken champions for carbon tax<sup>110</sup>. They do not, though.

The point is that a true internalization of the significance of their statements would force many of the BRT signatories to reconsider their whole operation. Another example is fossil fuels, which drove the contemporary world's growth. They would be incompatible with life if they were burned today. Will the fossil fuel corporations on new Statement's list establish strategies to wind down their primary activities? Or would these same corporations forego exploring the arctic and Greenland's natural riches, which have become more accessible as a result of the ice melting caused by fossil fuel use?<sup>111</sup> Unlikely. In fact, several of these signatories opposed any climate action, while making public remarks in favor of a carbon tax.

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<sup>106</sup> See Nell Minow, *Six Reasons We don't trust "Stakeholder" Promise*, *supra* note 104

<sup>107</sup> *Id.*

<sup>108</sup> See BUSINESS ROUNDTABLE STATEMENT, *supra* note 85

<sup>109</sup> See Andre Winston, *Is the business Roundtable Statement Just Empty Rhetoric?*, HARV. B. REV., (August 30, 2019) available at <https://hbr.org/2019/08/is-the-business-roundtable-statement-just-empty-rhetoric> (arguing the real impact of new BRT Statement on Corporate Governance issued in 2019) [hereinafter: Andrew Winston, *Is the business Roundtable Statement Just Empty Rhetoric?*]

<sup>110</sup> *Id.*

<sup>111</sup> *Id.*

Once again, the findings seem to be “*BRT is a good start, [...] yet the actual rate of development is light years beyond the BRT statement*”<sup>112</sup> and so the only way forward is to insist that they actually embrace long-term thinking and advocate for policies that support a healthy society; otherwise, their rhetoric is meaningless. Unfortunately, the need of demanding a substantive change in federal law is the same as Kristin Bresnahan's article for Directors&board<sup>113</sup>: the BRT statement makes no recommendation to amend state legislation guiding the fiduciary obligation to act in the corporation's and shareholders' best interests<sup>114</sup>.

### *C. Recalling the origin... A possible solution?*

A notable interpretation provided by Kent Greenfield in his book “*the Failure of Corporate Law*”, offers a novel point on the corporate purpose argument<sup>115</sup>. The book is a rebuttal against the previous two or three decades of misreading the history and nature of corporation law by “law and economics”.

Prof. Greenfield believes it is critical to take a step back when discussing corporate purpose: rather than focusing on “who” should benefit from corporate value, the conversation should concentrate on the nature of corporations. He recalls the roots of corporate law, when English chartered companies and American chartered firms were formed to perform “*quasi-public function*” in the nineteenth century<sup>116</sup> by telling “*early in our nation's history, a corporation was seen as a creation of the state rather than the product of private conduct, and corporate charters came with important conditions that protected the public interest*”<sup>117</sup>. Indeed, the very first England companies' objective was to colonize the Orient through trade, specialization, and commerce, as well as the early businesses in America sought to conquer the West in order to exploit the land and provide needed services. Corporations had the role to compensate for the embryonic American State's deficiencies.<sup>118</sup>

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<sup>112</sup> See Andrew Winston, *Is the business Roundtable Statement Just Empty Rhetoric?* *supra* note 109

<sup>113</sup> See Kristin Bresnahan, *The Purpose Debate Back to the 80's*, *supra* note 88

<sup>114</sup> *Id.*; see Andrew Winston, *Is the business Roundtable Statement Just Empty Rhetoric?* *supra* note 109

<sup>115</sup> See KENT GREENFIELD, *THE FAILURE OF CORPORATE LAW: FUNDAMENTAL FLAWS AND PROGRESSIVE POSSIBILITIES* (2006) [hereinafter GREENFIELD, *THE FAILURE OF CORPORATE LAW*].

<sup>116</sup> See GREENFIELD, *Corporations and History*, *THE FAILURE OF CORPORATE LAW: FUNDAMENTAL FLAWS AND PROGRESSIVE POSSIBILITIES* 77 (2006)

<sup>117</sup> *Id.* at 75

<sup>118</sup> *Id.* at 77-78

This is to imply that the present view of the corporation as being wholly regulated by private law is completely incorrect, since organizations that have performed a "*quasi-public function*" from its inception should really be controlled by public law. By relegating the corporation to the status of simply shareholders' property and treating management as simple agents pursuing their interests, the corporation's fundamental intent is violated<sup>119</sup>. In other words, performing a public role entails taking into account a secondary interest. The advantages that a corporation receives, most notably the limitation of liabilities, are a function of the public interest, as the corporations acquire the public interest. To reject its historical roots and reduce the corporation to a mere "nexus of contracts", that is, to a reality that serves private interests, is to dismiss the company's history and origins, as well as to expect private persons to have the right to liability limitation.<sup>120</sup>

The quasi-public function at the core of American charters justifies a corporate goal that is often aimed toward the public benefit. As a result, the prospect of considering interests other than investors' should come as no surprise.<sup>121</sup> Or it is reserved for individuals who have a strictly "private" view of corporate entities and are unaware of their history and origins. As he puts it, "*only when the law of corporations is evaluated as a branch of public law as we constitutional or environmental law will it be clear what type of changes can be made in corporate governance to improve the common good*"<sup>122</sup>. The point is that only when corporate law is seen as a branch of public law, as is the case with constitutional or environmental law, will it become evident what kind of improvements to corporate governance might be made to further the common good. Greenfield recommends improvements to corporate governance that would allow firms to pursue the progressive objective of wealth creation for society as a whole, rather than only for shareholders and executives<sup>123</sup>.

This is not to say that the corporate purpose is the answer; rather, it indicates that any aspect that is not openly shareholder-oriented or greedy (serving the wants of just

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<sup>119</sup> *Id.* at 80

<sup>120</sup> See GREENFIELD, *Corporate Law as Public Law*, THE FAILURE OF CORPORATE LAW 60

<sup>121</sup> *Id.* at 66-67

<sup>122</sup> See KENT GREENFIELD, THE FAILURE OF CORPORATE LAW, *supra* note 115 at 13. According to Prof. Greenfield the misconception that public corporations are typically seen as private institutions, and the law governing the is thought to belong to Private law, prevents public from having a much greater say in how corporations are managed.

<sup>123</sup> *Id.* at 16

stockholders) is neither innovative nor incongruous with the firm<sup>124</sup>. It is worth noting that this “quasi-public function” keeps popping up<sup>125</sup>.

*"Our nation could choose, and should choose," writes Greenfield, "to require that democratic values govern corporations, rather than having corporate values govern democracy."*<sup>126</sup> Certain tasks are just too critical to be delegated to for-profit businesses.

Another fundamental thesis of the book is that internal governance processes may help reduce external enforcement costs<sup>127</sup>. Greenfield takes aim at the law-and-economics paradigm, saying that shareholders are not the exclusive holders of ownership rights. While a stakeholder approach should be more efficient in the aggregate, he believes that society should forego the possibility of very large corporate profits in order to prevent disproportionate damage to workers and communities. This is particularly true considering that just a tiny percentage of wealthy shareholders stand to benefit from large earnings, with 1% owning 34% of all shares and 10% owning 77%<sup>128</sup>.

He concludes his work by making many suggestions. Extending the board's fiduciary responsibilities to encompass employees and other stakeholders. Relaxation of the profit maximization requirement and encouragement of stakeholder legislation<sup>129</sup>; A federal statute that protects employees against fraud, comparable to the Securities and Exchange Commission's Rule 10b-5, which protects investors<sup>130</sup>. Workers markets that are more efficient will direct labor to the most productive locations, putting an end to Delaware's supremacy. In the absence of federal chartering, states should use their authority to regulate the internal affairs of businesses. Generally, in other areas of law, the state with the largest interest triumphs. Corporate law, on the other hand, should be no different. What's great is that Prof. Greenfield backs up his argument with research on real behavior, not just economic theory. Furthermore, the essay is considered brilliant because, while the solutions proposed to address the flaws in the capitalist system are debatable, its historical

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<sup>124</sup> *Id.*

<sup>125</sup> *Id.*

<sup>126</sup> See KENT GREENFIELD, *Postscript: Getting Real About New Possibilities*, THE FAILURE OF CORPORATE LAW 469 (2006)

<sup>127</sup> GREENFIELD, *Do Corporations Have a Duty to Obey the Law*, THE FAILURE OF CORPORATE LAW 148-50 (2006)

<sup>128</sup> See Michael Elsby, *The Decline of the U.S. Labor Share*, *supra* note 4

<sup>129</sup> See GREENFIELD, *The Second Power of Corporate Law: Facilitating the Equitable Sharing of Surplus*, THE FAILURE OF CORPORATE LAW 330-31 (2006)

<sup>130</sup> *Id.* at 416 -17

exercise compels us to understand why issues of social and economic justice are so critical and intrinsic in our society, and not a secondary issue, as some believe today.

#### *IV. ESG AND WOKE CEOS*

##### *A. From corporate purpose to ESG*

However, the discussion over corporate purpose is already fading. America's top business and financial executives have now formally endorsed the rapidly growing ESG (Environmental, Social and Governance)<sup>131</sup> movement, reiterating that environment, social and corporate governance principles are intrinsically tied to business, risk value creation, financial performance, and sustainability.<sup>132</sup> The ESG movement has a narrower range of interest, and its main focus are on the applicability of those standard into investments, managerial and legislative decisions.

##### *1. ESG in Investment Decisions- The Origins*

The broader concept of economic responsibility stems from the financial sector ("socially responsible investing" or "SRI"), which flourished in the 1980s, when the problem of South African apartheid sparked a crisis and prompted ethical investors to attempt to divest from

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<sup>131</sup> Historically, the phrases "sustainable," "environmental, social, and governance (ESG)," and "corporate social responsibility" (CSR) were used interchangeably to refer to a business's voluntary efforts to control its environmental and social effect and improve its positive contribution to society. Throughout this paper, I will use the terms "sustainability" or "ESG" to refer to the strategic part of organizations' attempts to enhance performance on ESG concerns.

<sup>132</sup> See John Wilcox, Morrow Sodali, *A Common-Sense Approach to Corporate Purpose and Sustainability*, Harv. L. School Forum on Corp. Gov. & Fin. Reg., (Saturday 26,2019) available at <https://corpgov.law.harvard.edu/2019/10/26/a-common-sense-approach-to-corporate-purpose-esg-and-sustainability/#3b>

South African-based corporations<sup>133</sup>. Such ethical behaving has long been in conflict with trust fiduciary law, which mandates trustees to act only in the beneficiary's best interests<sup>134</sup>. Conceptually, they “rebranded” SRI investing and converted it into ESG investing by asserting that consideration of the “governance factors” associated with public corporations would enable the fiduciary to identify superior investments and enhance risk-adjusted return<sup>135</sup>. The term reaffirmed in 2004 when United Nations Secretary-General Kofi Annan pushed the world's largest financial institutions to include ESG issues into their capital allocation decisions, believing that doing so would actually benefit not just society and the environment, but also companies<sup>136</sup>.

But again, the issue seems to be that these attempts are lacking a clear grasp of the very real trade-offs between financial and ESG success. Typically, improving one comes at the expense of the other because shareholder primacy and stakeholder theory have dramatic differences in normative debates about what managers should do with ESG. Numerous studies, however, show that investor knowledge of ESG problems is growing quickly: according to the Global Sustainable Investment Review (GSIR), total US-domiciled asset management using sustainable investing increased from \$8.7 trillion in early 2016 to \$12.0

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<sup>133</sup> See Max M. Schanzenbach & Robert H. Sitkoff, *Reconciling Fiduciary Duty and Social Conscience: The Law and Economics of ESG Investing by a Trustee*, 72 STAN. L. REV. 381, 381 (2020). While political pressure may exist (particularly in the case of politically accountable public pension funds), this article will argue that sound economic reasons explain why fiduciaries at large diversified investors favor ESG principles, and thus ESG investing is likely to grow for reasons unrelated to political pressure. Interestingly, journalists write that, although governments in Europe have pressed oil corporations to include ESG factors into their decision-making, the impetus on US oil corporations to do the same has come entirely from major institutional investors. (and not at all from the government) See Stanley Reed, *Europe's Oil Titans Ramp Up Transition To Cleaner Energy*, N.Y. TIMES, August 17, 2020 at B-1, 3

<sup>134</sup> Under what is known as the “sole interest” rule, a trustee must “administer the trust solely in the interest of the beneficiaries.” 3 RESTATEMENT (THIRD) OF TR. §78(1) (AM. L. INST. 2007) Under a comment to this section, the Restatement adds that “the trustee has a duty to the beneficiaries not to be influenced by the interests of any third person or by motives other than the accomplishment of the purposes of the trust.” 3 RESTATEMENT OF TR. §78(1) cmt. F (AM. L. INST. 2007)

<sup>135</sup> See Coffee, John C., *The Future of Disclosure: ESG, Common Ownership, and Systematic Risk* (March 16, 2021). EUROPEAN CORPORATE GOVERNANCE INSTITUTE - Law Working Paper 541/2020, Available at SSRN: <https://ssrn.com/abstract=3678197> or <http://dx.doi.org/10.2139/ssrn.3678197> I borrow the term “rebranding” from Schanzenbach & Sitkoff, *supra* note 98, at 388. A key moment in this semantic transition from SRI to ESG came in 2005 with the release of a report sponsored by a UN working group and prepared by the international law firm of Freshfields Bruckhaus Deringer, which asserted that ESG investing was not only consistent with the trustee’s fiduciary duties but was “arguably required in all jurisdictions.” UNEP FIN. INITIATIVE, A LEGAL FRAMEWORK FOR THE INTEGRATION OF ENVIRONMENTAL, SOCIAL AND GOVERNANCE ISSUES INTO INSTITUTIONAL INVESTMENT 13 (2005); see also Schanzenbach & Sitkoff, *supra* note 98, at 389.

<sup>136</sup> See Karen Firestone, *How Investors Have Reacted to the Business Roundtable Statement*, HAR. B. REV. (November 20, 2019) see <https://hbr.org/2019/11/how-investors-have-reacted-to-the-business-roundtable-statement>



trillion in early 2018, a 38 percent increase that accounts for 26% of all investment assets under professional management in the United States<sup>137</sup>.

## 2. ESG in Managerial decisions: the phenomenon of Woke CEOs.

But, while investors strive to integrate ESG considerations into their investment decisions, some CEOs of significant American corporations are striving to demonstrate their commitment to the ESG cause, to the point that the conservative wing has dubbed them “Woke CEOs”<sup>138</sup>. Indeed, the executives had begun to highlight their commitment to public benefit in announcing the company's new policy.

However, this pattern has degenerated considerably, with CEOs expressing high-profile positions on very sensitive political issues<sup>139</sup>. Georgia's case, in particular, has aroused outrage, with many CEOs of prominent firms, most notably Coca-Cola and Delta, expressing their scorn for and opposition to new voting law that they claim to be unlawful due to its limitation of minorities' voting rights. Delta's CEO Ed Bastian would have said “*Since the bill's inception, Delta joined other major Atlanta corporations to work closely with elected officials from both parties, to try and remove some of the most egregious measures from the bill. However, I need to make it crystal clear that the final bill is unacceptable and does not match Delta's values*”<sup>140</sup>. While James Quincey, the CEO of Coca-Cola, in a new statement issued on April 1 said that his company “*long championed efforts to make it easier to vote*” and has previously opposed legislation that “*would diminish or deter access to voting*.”<sup>141</sup> Moreover, “*We all have a duty to protect everyone's right to vote, and we will continue to stand up for what is right in Georgia and across the US*”.<sup>142</sup> Bastian and Quincey's remarks follow other executives' condemnation of the new legislation, including other Black CEOs urging executives to resist moves to limit voting rights<sup>143</sup>.

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<sup>137</sup> Global sustainable investment Alliance (2018) see [http://www.gsi-alliance.org/wp-content/uploads/2019/03/GSIR\\_Review2018.3.28.pdf](http://www.gsi-alliance.org/wp-content/uploads/2019/03/GSIR_Review2018.3.28.pdf)

<sup>138</sup> See Welch, Kyle and Yoon, Aaron, *Do High Ability Managers Choose ESG Projects that Create Shareholder Value? Evidence from Employee Opinions* (June 2, 2020). Available at SSRN: <https://ssrn.com/abstract=3616486> or <http://dx.doi.org/10.2139/ssrn.3616486>

<sup>139</sup> Elliot Kaufman, “Woke” CEOs: *Risky Business or the Next Great Awakening?*, THE WALL STREET JOURNAL (May 3, 2021) electronic copy available at <https://www.wsj.com/articles/woke-ceos-risky-business-or-the-next-great-awakening-11620061496> [hereinafter: Elliot Kaufman, “Woke” CEOs]

<sup>140</sup> Ed Bastian, *Your Right to Vote*, DELTA NEWS HUB (March 31, 2021) see <https://news.delta.com/ed-bastian-memo-your-right-vote>

<sup>141</sup> *Id.*

<sup>142</sup> *Id.*

<sup>143</sup> Elliot Kaufman, “Woke” CEOs, *supra* note 139

The point is: are they standing up for their convictions or adhering to the new party line?<sup>144</sup> On one level, the discussion is about striking a balance between voter access and election security; on another, it is about fundamental issues such as imposed conformity, American culture, and capitalism's destiny.

One would assume that CEOs would not have undertaken an appropriate cost-benefit analysis after exposing themselves to such a sensitive dispute. Indeed, Harvey Golub cautions them in his piece "*Politics is a Dangerous Business for CEOs*", in which he outlines four distinct reasons why exposing oneself to so much politics would have really harmed their image with Americans. Among the different grounds, there is the fact that given the high visibility their position implies, they can never speak merely as individuals, because when they speak, they represent the companies they head. They do have the right, and perhaps the obligation to speak on matters that affect their organization, but unless they have asked their board for approval, they don't have that right on unrelated matters<sup>145</sup>. Moreover, "*those positions will always lead to unintended consequences, as in the Georgia situation*". He was indeed correct: as a result of Ted Cruz's words, a US senator from Texas, the CEOs were swamped by a "boomerang effect". He would respond with "*one of the most blatantly corrupt statements any Senator has ever made,*" <sup>146</sup>as reported by Walter Shaub a former director of the Office of Government Ethics, telling "*America's watch-me-wake-it-up CEOs, I say: When the time comes for you to seek assistance with a tax cut or regulatory reform, I hope the Democrats take your calls, because we may not.*"<sup>147</sup> Indeed, the senator's statements have revealed years of collusion between federalist politicians and the CEOs in question, along with all of the advantages that businesses have reaped in recent years. The senator refers to Coca-Cola being excused from paying \$12 million dollars in taxes, as well as billions of dollars in corporate welfare advantages awarded to the airline Boeing, thereby undermining their phony respectability. <sup>148</sup>

However, it did not stop there, and after Ted Cruz's words, an avalanche of hypocritical allegations deluged the CEOs. A conservative organization started an advertising campaign

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<sup>144</sup> *Id.*

<sup>145</sup> Harvey Golub, *Politics Is Risky Business for CEOs*, THE WALL STREET JOURNAL (April 12, 2021) [https://www.wsj.com/articles/politics-is-risky-business-for-ceos-11618265960?mod=article\\_inline](https://www.wsj.com/articles/politics-is-risky-business-for-ceos-11618265960?mod=article_inline)

<sup>146</sup> Ted Cruz, *Your Woke Money Is No Good Here*, THE WALL STREET JOURNAL (April 28, 2021) available at [https://www.wsj.com/articles/your-woke-money-is-no-good-here-11619649421?mod=article\\_inline](https://www.wsj.com/articles/your-woke-money-is-no-good-here-11619649421?mod=article_inline) [hereinafter: Ted Cruz, *Your Woke Money Is No Good Here*]

<sup>147</sup> See Elliot Kaufman, "*Woke*" CEOs, *supra* note 139

<sup>148</sup> See Ted Cruz, *Your Woke Money Is No Good Here*, *supra* note 146.

to oppose "woke capitalism," spending more than \$1 million on commercials targeting Coca-Cola<sup>149</sup>, American Airlines, and Nike executives. The advertisements are scathing in their criticism of CEOs on a variety of subjects, from kid obesity to charges of forced labor in China<sup>150</sup>. Coca-Cola's case has been particularly troubling: the company would have been criticized as hypocritical for a variety of reasons, including the fact that their beverage is a significant contributor to obesity, an illness that weakens an important percentage of the American population. Thus, although its CEO claims to be acting in the public interest by denouncing the new election legislation, it does not face the same issue of public health by making a drink so harmful to health its primary business<sup>151</sup>. Is its interest in public protection so restricted to those areas that do not directly affect him? The same logic can be extended to all other corporations mentioned in the argument, demonstrating that "Woke capitalism" has unavoidable boundaries. According to The Wall Street Journal's editorial board, CEOs' ultimate goal is not to be consistent with their activities, but rather "old-fashioned self-interest," since CEOs are aware that Democrats are in power and want to be on the right side of a government that may hurt them. If this requires sacrificing values in order to create a political safe zone for their enterprise, then be it.<sup>152</sup>

However, this is not to imply that these CEOs lack greater motivations, and self-interest is not considered a sin in our moral language. The argument is that companies prioritize their own interests above all else, which often entails partnering with government for limited ends that are not necessarily in the general interest<sup>153</sup>.

Some pro-CEO voices have been heard, such as Jeffrey Sonnenfeld, who argued that while CEOs are not always coherent, *"This business awakening shouldn't be ridiculed but celebrated as the rediscovery of a misunderstood pillar of America's industrial greatness."*<sup>154</sup>

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<sup>149</sup> Coca-Cola would have been criticized as hypocritical for a variety of reasons, including the fact that their beverage is a significant contributor to obesity, an illness that weakens a significant percentage of the American population. Thus, although its CEO claims to be acting in the public interest by denouncing the new election.

<sup>150</sup> See Eamon Javers, *Conservative Group Launches Ad Campaign Against "Woke Capitalism", Targeting CEOs by Name*, CNBC (May 18, 2021) available at <https://www.cnbc.com/2021/05/18/conservative-group-launches-ad-campaign-targeting-nike-coca-cola-american-airlines-ceos.html>

<sup>151</sup> *Id.*

<sup>152</sup> See The Editorial Board, *Down With Big Business, Again*, THE WALL STREET JOURNAL (May 18, 2021) <https://www.cnbc.com/2021/05/18/conservative-group-launches-ad-campaign-targeting-nike-coca-cola-american-airlines-ceos.html>

<sup>153</sup> *Id.*

<sup>154</sup> See Jeffrey Sonnenfeld, *CEOs Lead America's New Great Awakening*, THE WALL STREET JOURNAL (April 15, 2021) see [https://www.wsj.com/articles/ceos-lead-americas-new-great-awakening-11618505076?mod=article\\_inline](https://www.wsj.com/articles/ceos-lead-americas-new-great-awakening-11618505076?mod=article_inline)

Moreover, assuring social cohesiveness in a democracy is a critical component of a CEO's strategic environment management. No CEO wants finger-pointing staff interacting with angry customers and communities—even if “wedge” topics appeal to Republican legislators seeking to retain office via a divide-and-conquer strategy<sup>155</sup>.

### 3. *Social criticism function*

However, capitalism's disparities are much too significant a point to be dismissed in the "Woke CEO" fashion. Of course, if this trend becomes a societal deterrent against selfish individuals, they may assist by serving as an instructional tool, even though public shame is not a legal standard, it may serve as a catalyst for improved standards of conduct targeted at the general good. Can this be relied upon? It is beneficial, yet insufficient.

If this were the case, the law would lose its meaning and the purpose for its being would vanish. The ability to appeal a ruling and have the issue heard in court remains a vital need. As such, the new "Awakening," if it occurs, is critical if it results in a tangible reform, complete with a moment of absorption in the law.

If we do not receive legal confirmation as a result of the controversy, it remains true that anyone who opposes a campaign aimed at the public benefit of an administrator and sues them will lose the case inexorably if the CEO is unable to demonstrate that the given campaign results in an effective benefit to the shareholder.

Indeed, courts are still compelled to use the current criteria, namely that of shareholder profit maximization. A foundational doctrine of Delaware law is that When a board of directors decides to sell the company, the transaction must be structured in such a way that the greatest reasonable price is obtained<sup>156</sup>. In the landmark case *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*<sup>157</sup>, the Delaware Supreme Court held that, when a sale of the corporation becomes inevitable, the “directors' role change[s] from defenders of the corporate bastion to auctioneers charged with getting the best price for the stockholders...”<sup>158</sup> Which is why, as long as this standard is in effect, any recall of a director for

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<sup>155</sup> *Id.*

<sup>156</sup> See Jay B. Kesten, Adjudicating Corporate Auctions, YALE J. ON REG. Vol. 32 (2015)

<sup>157</sup> *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.* - 506 A.2d 173 (Del. 1986)

<sup>158</sup> *Id.* This Article follows established practice in the literature by concentrating on Delaware corporate law, owing to the state's national leadership in corporate concerns. The arguments made in this article are generalizable to any country where corporate fiduciaries are subject to Revlon-like requirements.

shareholder misbehavior will be deemed null and invalid. This is also one of the reasons why Prof. Greenfield advocates for the end of Delaware's dominance<sup>159</sup>.

## V. SHAREHOLDERISM VS STAKEHOLDERISM

I discussed the condemnation meted out to the ideology of "shareholderism" in earlier chapters; in this part, I will attempt to understand the factors that contributed to this vision's degeneration. I will also discuss stakeholderism in order to assess the issue and comprehend how this might be regarded a remedy to the ills.

### A. *The Shareholder primacy*

Even prior to the 2019 Business Roundtable declaration, numerous opponents cited shareholder primacy as the major reason for contemporary capitalism's perversion. The theory's fundamental premise is that shareholders control the firm and hence have ultimate power over its operations.

Already in 1970, Professors Joseph L. Bower and Lynn S. Paine argued that maximizing shareholder value was “pernicious nonsense”<sup>160</sup>, because it is “*the error at the heart of corporate leadership*”<sup>161</sup>. It is “*flawed in its assumptions, confused as a matter of law, and damaging in practice*” as they illustrate its failure to address the “accountability vacuum” created by shareholders – many of whom are essentially short-term investors, having no actual duty to the business whose stock they own<sup>162</sup>.

Indeed, the shareholding system's weaknesses have been addressed throughout economic history by people who have been pioneers in their own right: One of them was Jack Welch,

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<sup>159</sup> See KENT GREENFIELD, THE FAILURE OF CORPORATE LAW, *supra* note 129

<sup>160</sup> See Adi Ignatius, *Are We Giving Shareholders Too Much Power?* HARV. B. REV. (May 2017) see <https://hbr.org/2017/05/are-we-giving-shareholders-too-much-power>

<sup>161</sup> Joseph L. Bower and Lynn S. Paine, *The Error at the Heart of Corporate Leadership*, HARV. B. REV. (May-June 2017) pp. 50-60 <https://hbr.org/2017/05/the-error-at-the-heart-of-corporate-leadership> [hereinafter: Bower & Paine, *The Error at the Heart of Corporate Leadership*]

<sup>162</sup> *Id.*

who was generally regarded as a leader of maximizing shareholder value, during his tenure as CEO of General Electric from 1981 to 2001. He has been even crueler in reconsidering the entire theory when declared in 2009 that shareholder value is “*the dumbest idea in the world*”, because “*Shareholder value is a result, not a strategy*”<sup>163</sup>. Moreover, since the main constituencies of a company are workers, customers and products, “*managers and investor should not set share price increases as their overarching goal [...] Short-term profits should be allied with an increase in the long-term value of a company*”<sup>164</sup>

Despite the storms of criticism directed against shareholderism throughout economic history, the theory's "pernicious nonsense" has been able to propagate. Nowadays we are more than aware that shareholder value thinking is prevalent across the financial sector and most of the corporate sectors, which is tangible in a set of behaviors on a broad variety of issues, ranging from performance measurement and CEO remuneration to shareholder rights, the board position, and corporate responsibility.”<sup>165</sup>

Thus, two conflicting schools of thought exist: shareholder value is either the finest business concept or the worst business concept ever. Which one is this?

### B. The “Faultline”

When discussing Shareholderism theory, I find it useful to use Kent Greenfield's historical exercise approach to Corporate Purpose<sup>166</sup>.

If he thought it was crucial to emphasize and remember the *quasi-public purpose* that was the major reason companies were founded in nineteenth-century America, it is equally crucial to take a step back and recall why the shareholder-centric vision was embraced in the 1940s. In doing so, Professor Denning’s Forbes article written comes in help.<sup>167</sup> The professor reminds us that in the mid-twentieth century, the traditional thinking about how to operate a business was labeled "managerial capitalism." The concept was that public enterprises should be managed by professionals who would balance the demands of many

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<sup>163</sup> Steve Denning, *The Dumbest Idea In The World: Maximizing Shareholder Value*, FORBES (November 28, 2011) <https://www.forbes.com/sites/stevedenning/2011/11/28/maximizing-shareholder-value-the-dumbest-idea-in-the-world/?sh=2239e3172287> [hereinafter: Steve Denning, *The Dumbest Idea in the World* ]

<sup>164</sup> *Id.*

<sup>165</sup> See Francesco Guerrera, *Welch Condemns Share Price Focus*, FIN. TIMES (March 12, 2009) see <https://www.ft.com/content/294ff1f2-0f27-11de-ba10-0000779fd2ac#axzz1eiLpL2PZ>

<sup>166</sup> See KENT GREENFIELD, *THE FAILURE OF CORPORATE LAW*, *supra* note 115

<sup>167</sup> See Steve Denning, *The Dumbest Idea in the World*, *supra* note 163

stakeholders while also considering public policy.<sup>168</sup> However, as globalization took hold, balance began to disintegrate. That kind of management was incapable of coping with technological advancements, and organizations got confused. Balancing assertions made by professional managers seemed reasonable in principle, but often resulted in inconsistent and ill-defined priorities in fact. Occasionally, even the management of the organizations were unable to comprehend their own procedures. Decision-making became unpredictable and capricious; a clearer clarity of purpose was necessary.

### 1. *Customer Value*

Peter Drucker's 1954 book "The Practice of Management" provided one solution: "*There is only one legitimate definition of business purpose,*" he said categorically, and it is "*to generate a customer*"<sup>169</sup>, because it is the consumer who defines the nature of a business. For him is the client, and only the client, who changes economic resources into riches, things into products, by being willing to pay for an item or service. What the company believes and creates is secondary, especially not to the firm's future and success, while what the client believes he is purchasing, what he regards to be 'value,' is decisive—it defines the nature of a firm, the products it creates, and its viability.<sup>170</sup>

Drucker's idea was a clear break from traditional knowledge and garnered nothing more than rhetorical regard at the time. However, developments in the marketplace consistently reaffirmed Drucker's argument. Deregulation, globalization, the rise of knowledge labor, and new technology have all resulted in a change in the commercial center of gravity: from supplier to buyer<sup>171</sup>.

### 2. *Shareholder value*

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<sup>168</sup> See Steve Denning, *The Dumbest Idea in the World*, *supra* note 163 ; see also Cydney Posner, *So Long to Shareholder Primacy*, 2019 HAR. L. SCHOOL FORUM ON COR. GOV. & FIN. REG. <https://corpgov.law.harvard.edu/2019/08/22/so-long-to-shareholder-primacy/>

<sup>169</sup> PETER DRUCKER, *THE PRACTICE OF MANAGEMENT* (1954) [hereinafter: DRUCKER, *THE PRACTICE OF MANAGEMENT*]

<sup>170</sup> Alan Kantrow, *Why Read Peter Drucker?* 2009 HARV. B. REV. <https://hbr.org/2009/11/why-read-peter-drucker> ; See Steve Denning, *The Dumbest Idea in the World*, *supra* note 163

<sup>171</sup> *Id.*

The problem was that the majority of public firms in the United States took the other path and established a priority on shareholder value. Of course, their first proponent was Milton Friedman—who would earn the 1976 Nobel Prize in Economics—which asserted in his 1962 book *Capitalism and Freedom* that “*business has one and only social responsibility—to use its resources and engage in activities designed to increase its profits.*”<sup>172</sup>

For executives seeking to navigate the continuous "apocalypse of change," Friedman's approach provided attracting clarity: managers need only concentrate on profit maximization; everything else would take care of itself.<sup>173</sup> Friedman's piece came at the perfect time. Executives were relieved of the responsibility of balancing the claims of workers, customers, the business, and society.<sup>174</sup> They could focus their efforts on increasing shareholder value. The situation deteriorated further in 1976, when Wiliam Meckling and Michael Jenses proposed a quantitative economic explanation for increasing shareholder value, as well as hefty stock-based pay for executives who adhered to the theory. Their objective was to discourage managers from acting in their own self-interest while doing business by aligning their objectives with those of investors. Compensation in shares would convert executives into co-owners of the business, so protecting the other co-owners—the shareholders—from managers squandering funds on corporate jets. They will only function as proprietors. Finally, a 1990 essay in the *Harvard Business Review* by finance professors Michael C. Jensen and Kevin J. Murphy served as a booster. According to the article, “*CEO Incentives—Not It's How Much You Pay, But How,*”<sup>175</sup> many CEOs are still compensated like bureaucrats, which causes them to behave like bureaucrats. Rather than that, they should be compensated with considerable quantities of stock to ensure that their interests are aligned with those of investors. “Is it any wonder,” Jensen and Murphy asked, “*that so many CEOs act like bureaucrats rather than the value-maximizing entrepreneurs that companies need to enhance their presence in international markets?*”<sup>176</sup>

Since then, the term “*maximize shareholder value*” became American capitalism’s dogma.

### 3. Shareholder Value degradation and potential solutions

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<sup>172</sup> MILTON FRIEDMAN, *CAPITALISM AND FREEDOM*, (2002)

<sup>173</sup> See Steve Denning, *The Dumbest Idea in the World*, *supra* note 163

<sup>174</sup> *Id.*

<sup>175</sup> Jensen, Michael C. and Murphy, Kevin J., *CEO Incentives: It's Not How Much You Pay, But How*, 3 HARV. B. REV., May- June 1990 pp. 138-153. available at <https://hbr.org/1990/05/ceo-incentives-its-not-how-much-you-pay-but-how>

<sup>176</sup> *Id.*



Even in this case, Greenfield's quasi-public recalled function reappears, and it makes perfect sense. Prior to the onset of globalization in the mid-twentieth century economy, the balance between shareholder and stakeholder interests that we are now arguing was already there and well-considered. This exasperation on the part of the shareholder primacy was the outcome of simple decisions preferred to just decisions. When managers found themselves overseeing corporations whose primary purpose was unclear even to themselves in the mid-nineteenth century, they required an easy tool to assist them re-calibrate the compass needle and re-identify the direction in which the firm should have gone. Peter Drucker's course would have been the correct one, but it would have been also the most difficult and "uncomfortable."

Bower and Paine, among others, point out that shareholder value thinking has "*increased the power and influence of certain types of shareholders over other types... and other important constituencies — without establishing any corresponding responsibility or accountability on the part of shareholders who exercise that power.*"<sup>177</sup>

And even *The Economist* writes that shareholder value thinking has become a "*license for bad conduct, including skimping on investment, exorbitant pay, high leverage, silly takeovers, accounting shenanigans and a craze for share buy-backs, which are running at \$600 billion a year in America*"<sup>178</sup>. Thus, what drives business today is a degraded form of shareholder value theory—the assumption that a firm's mission is to maximize shareholder value as reflected in its present stock price. The notion that most organizations make choices based on "whether the capital employed generated a reasonable return, as measured by its cash flow compared to a hurdle rate (the risk-adjusted return anticipated by capital providers) is a fiction.

Finally, the advanced form of "long-term discounted cash flows" is unsuitable for decision-making on a daily basis. And the distorted form known as "the present stock price" results in widespread short-termism, excessive share buybacks at the expense of investment, ballooning C-suite salaries, and economic misallocation. Which leads us back to the first chapter's justifications for the elements of Bernie Sanders' Reward Work Act<sup>179</sup> that aim to permanently contain the issue.

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<sup>177</sup> See Bower & Paine, *The Error at the Heart of Corporate Leadership*, *supra* note 161

<sup>178</sup> Dave Simmonds, *Analyse This*, *THE ECONOMIST*, 2016. Available at: <https://www.economist.com/business/2016/03/31/analyse-this>

<sup>179</sup> See REWARD WORK ACT, *supra* note 7

However, the method by which this will be accomplished elicits significant divergences of opinion and practical difficulties. Certain advocates bet on voluntary cooperation between corporations, large institutional investors, and other stakeholders. However, given the financial incentives available to corporate executives and directors under the current system, particularly in the Anglo-American system heavily reliant on equity-based compensation, voluntarism alone is unlikely to move the needle far enough<sup>180</sup>.

Others establish a new structure for corporate governance in order to foster the rise of "stakeholder capitalism."<sup>181</sup>

Several examples include Martin Lipton's "New Paradigm"<sup>182</sup> and a framework suggested by a Harvard team of students based on the 2011 UN Guiding Principles on Business and Human Rights (UNGPs)<sup>183</sup>. Other Articles advocate for a view of the business and its mission that transcends the shareholder-stakeholder divide, proposing the adoption of the UK's statutory "enlightened shareholder value" approach to corporate stakeholders, including the environment, workers, and local communities<sup>184</sup>.

## VI. CONCLUSIONS

Although previous reactions from the political, managerial, and legal communities have been inadequate to reconstruct a more equitable social model, I think they should serve as a springboard for soliciting comment on a new legal and economic ethic.

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<sup>180</sup> John Ruggie, *Making "Stakeholder Capitalism" Work: Contributions from Business & Human Rights*, 2021 Har. L. School Forum On Corp. Gov. & Fin. Reg. <https://corpgov.law.harvard.edu/2021/02/10/making-stakeholder-capitalism-work-contributions-from-business-human-rights/>

<sup>181</sup> *Id.*

<sup>182</sup> INTERNATIONAL BUSINESS COUNCIL OF THE WORLD ECONOMIC FORUM, *The New Paradigm*, (January 16, 2020) Available at: <https://www.wlrk.com/webdocs/wlrknew/AttorneyPubs/WLRK.25960.16.pdf>; The New Paradigm establishes a set of corporate management principles aimed at assisting institutional investors and asset managers in monitoring firms. It acknowledges that, although shareholders do have a right to residual free cash flow, they are not the corporation's sole owners)

<sup>183</sup> See Ruggie, John Gerard and Rees, *Caroline and Davis, Rachel, Making 'Stakeholder Capitalism' Work: Contributions from Business & Human Rights* (November 19, 2020). (HKS Working Paper No. RWP20-034) Available at SSRN: <https://ssrn.com/abstract=3733228> or <http://dx.doi.org/10.2139/ssrn.3733228>

<sup>184</sup> See Harper Ho, Virginia E., *'Enlightened Shareholder Value': Corporate Governance Beyond the Shareholder-Stakeholder Divide* (August 11, 2010). 36 JOURNAL OF CORPORATION LAW, No. 1, p. 59, 2010, Available at SSRN: <https://ssrn.com/abstract=1476116> or <http://dx.doi.org/10.2139/ssrn.1476116>

While this notion of shareholder primacy as it is now practiced is a degenerate form of how it was initially envisioned, it remains an incorrect approach to conceptualize and operate businesses. Historical research must be used to comprehend this. However, this study does not seek to evaluate which of the new models offered is the best or most suited. Rather than that, it is to assist in giving voice to the socioeconomic classes that are paying the price for the ruling class's years of egoism.

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