Easterbrook and Fischel on Corporate Purpose

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Frank Easterbrook and Daniel Fischel's comments on corporate purpose are as fresh today as they were when they were first published in the 1980s. Starting from the "contractarian" perspective, they asked a key question about questions such as "what is the goal of the corporation?", namely, "Who cares?"

In this contribution to the symposium volume in their honor, I examine the current corporate purpose debate through the lens of their rather brief comments that first appeared in their 1989 article, "The Corporate Contract." In doing so, I focus on a variety of issues raised by their analysis: What are the default settings of the corporate contract? How does one contract out of the default settings? What are the limits to tailoring the default form? How does corporate law address surprise departures from initial commitments?

Examining these current issues through the lens of The Economic Structure of Corporate Law *demonstrates the enduring value of Easterbrook and Fischel's framework.*

I. INTRODUCTION 397
II. WHAT ARE THE DEFAULT SETTINGS OF THE CORPORATE "CONTRACT"? ...401
A. "Contracting" Out of the Default Settings 404
III. PROTECTION AGAINST "SURPRISE." 408
IV. SO WHAT DOES ESCL TELL US ABOUT THE "CORPORATE PURPOSE" DEBATE? 413

I. INTRODUCTION

I started teaching in January 1989 after spending five years practicing as a litigator. As I began to prepare to teach the basic Corporations course, I immersed myself in the academic literature. The stream of articles produced by Frank Easterbrook and Daniel Fischel (E&F) during the 1980s—which were ultimately reworked into *The Economic Structure of Corporate Law*

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(ESCL),[1]—provided the analytic framework within which I learned to think about corporate law from a "law and economics" perspective. In a fundamental way, ESCL "imprinted" me as a baby academic.[2]

Inevitably, as I think through new issues arising in corporate law, I channel their analytic approach, often looking to ESCL to see whether they have covered the issue and asking myself "how would they think about this?" Never has that been so useful as over the last couple of years with the debate over "corporate purpose" grabbing corporate governance headlines.[3] It seems to be everywhere. BlackRock CEO Larry Fink has called for companies to articulate 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.[4]

The Business Roundtable, an organization of chief executive officers (CEOs) of America's leading companies, has issued a "Statement on the Purpose of a Corporation."[5] This statement, signed by 181 CEO members, set forth a broad and inclusive conception of the corporate purpose:

> While each of our individual companies serves its own corporate purpose, we share a fundamental commitment to all of our stakeholders. We commit to:

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[1] FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW (1991).

[2] Bernd Heinrich, *Dances with Geese*, N.Y. TIMES (Feb. 16, 1992), https://perma.cc/8Z3X-5ZFG ("Lorenz, who died in 1989, is best known for his theory of rapid learning, or imprinting, which occurs most conspicuously in newly hatched birds as they bond to their parents (or to any other moving object that happens to be near). But as Lorenz shows, imprinting can also occur in humans.").

[3] Edward B. Rock, *For Whom Is the Corporation Managed in 2020?: The Debate Over Corporate Purpose*, 76 BUS. LAW. 363 (2021) [hereinafter Rock, *For Whom Is the Corporation Managed in 2020?*]; Edward B. Rock, *Business Purpose and the Objective of the Corporation*, *in* RESEARCH HANDBOOK ON CORPORATE PURPOSE AND PERSONHOOD 27–46 (Elizabeth Pollman & Robert Thompson eds., 2021).

[4] Letter from Larry Fink, Chairman & CEO, BlackRock, to CEOs (Jan. 2018), https://perma.cc/7UTN-3UQV.

[5] *Statement on the Purpose of a Corporation*, BUS. ROUNDTABLE (Aug. 19, 2019), https://perma.cc/972D-DC42.

> > - Delivering value to our customers. We will further the tradition of American companies leading the way in meeting or exceeding customer expectations.
> > - Investing in our employees. This starts with compensating them fairly and providing important benefits. It also includes supporting them through training and education that help develop new skills for a rapidly changing world. We foster diversity and inclusion, dignity and respect.
> > - Dealing fairly and ethically with our suppliers. We are dedicated to serving as good partners to the other companies, large and small, that help us meet our missions.
> > - Supporting the communities in which we work. We respect the people in our communities and protect the environment by embracing sustainable practices across our businesses.
> > - Generating long-term value for shareholders, who provide the capital that allows companies to invest, grow and innovate. We are committed to transparency and effective engagement with shareholders.
>
> Each of our stakeholders is essential. We commit to deliver value to all of them, for the future success of our companies, our communities and our country.[6]

Klaus Schwab, founder and Executive Chairman of the World Economic Forum, the group that holds a high-profile annual meeting of international business and political leaders in Davos, Switzerland, issued the "Davos Manifesto 2020: The Universal Purpose of a Company in the Fourth Industrial Revolution" in which he stated that:

> The purpose of a company is to engage all its stakeholders in shared and sustained value creation. In creating such value, a company serves not only its shareholders, but all its stakeholders—employees, customers, suppliers, local communities and society at large. The best way to understand and harmonize the divergent interests of all stakeholders is through a shared commitment to policies and decisions that strengthen the long-term prosperity of a company.[7]

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[6] *Id.*

[7] Klaus Schwab, *Davos Manifesto 2020: The Universal Purpose of a Company in the Fourth Industrial Revolution*, WORLD ECON. F. (Dec. 2, 2019), https://perma.cc/Q2RP-2NYK.

Colin Mayer, in his book *Prosperity* and his work with the British Academy, has argued for the primacy of "purpose" and emphasizes some of the same themes:

> The purpose of companies is to produce solutions to problems of people and planet and in the process to produce profits, but profits are not per se the purpose of companies. They are derivative from purpose rather than fundamental in their own right.[8]

More recently, Prof. Mayer, and the British Academy's *Future of the Corporation* project that he led, has called for "purpose" to be mandatory and legally enforced.[9]

As I have thought through the "corporate purpose" movement, a movement that could well result in changes in corporate law, governance and regulation, I have asked myself "What would Frank and Dan think?" Turning to ESCL, I revisited a passage that I remembered from my first reading of the article that later became chapter one:

> An approach that emphasizes the contractual nature of a corporation removes from the field of interesting questions one that has plagued many writers: what is the goal of the corporation? Is it profit (and for whom)? Social welfare more broadly defined? Is there anything wrong with corporate charity? Should corporations try to maximize profit over the long run or the short run? Our response to such questions is: "Who Cares?" If the New York Times is formed to publish a newspaper first and make a profit second, no one should be allowed to object. Those who came in at the beginning actually consented, and those who came in later bought stock at a price reflecting the corporation's tempered commitment to a profit objective. If a corporation is started with a promise to pay half of the profits to the employees rather than the equity investors, that too is simply a term of the contract. It will be an experiment. We might not expect the experiment to succeed, but such expectations by strangers to the bargain are no objection. Similarly, if a bank is formed with a declared purpose to prefer loans to minority-owned businesses,

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[8] COLIN MAYER, PROSPERITY: BETTER BUSINESS MAKES THE GREATER GOOD 109 (2018); *see also id.* at 40.

[9] BRITISH ACAD., POLICY & PRACTICE FOR PURPOSEFUL BUSINESS 25 (2021), https://perma.cc/5BSU-APDY; Colin Mayer, *The Governance of Corporate Purpose*, (Eur. Corp. Governance Inst., Law Working Paper No. 609/2021, 2021), https://perma.cc/D6HF-AZWP.

> or to third-world nations, that is a matter for the venturers to settle among themselves. So too if a corporation, on building a plant, undertakes never to leave the community. Corporate ventures may select their preferred "constituencies." The one thing on which a contractual framework focuses attention is surprise. If the venture at its formation is designed in the ordinary fashion—employees and debt investors holding rights to fixed payoffs and equity investors holding a residual claim to profits, which the other participants promise to maximize—that is a binding promise. If the firm suddenly acquires a newspaper and declares that it is no longer interested in profit, the equity investors have a legitimate complaint. It is a complaint for breach of contract, not for derogation from some ethereal ideal of corporate governance. The role of corporate law here, as elsewhere, is to adopt a background term that prevails unless varied by contract. And the background term should be the one that is either picked by contract expressly when people get around to it or is the operational assumption of successful firms. For most firms the expectation is that the residual riskbearers have contracted for a promise to maximize long-run profits of the firm, which in turn maximizes the value of their stock. Other participants contract for fixed payouts—monthly interest, salaries, pensions, severance payments, and the like. This allocation of rights among the holders of fixed and variable claims serves an economic function. Riskbearers get a residual claim to profit; those who bear risk on the margin get fixed terms.[10]

"Who cares?" they ask. What a refreshingly deflationary response to a question that has provoked so much passion! There is much in this passage to unpack in the context of the debate over corporate purpose, and doing so is the goal of this paper. I want to focus on the following issues raised in the quoted passage: what is the default setting for the corporate "contract"?; how can one depart from that default setting, i.e., how much freedom of contracting is there and how does one avail oneself of it?; and how does corporate law handle surprise departures from initial commitments?

II. WHAT ARE THE DEFAULT SETTINGS OF THE CORPORATE

[10] EASTERBROOK & FISCHEL, *supra* note 1, at 35–36.

"CONTRACT"?

What is the default "corporate purpose"? E&F adopt a "shareholder primacy" view:

> If the venture at its formation is designed in the ordinary fashion—employees and debt investors holding rights to fixed payoffs and equity investors holding a residual claim to profits, which the other participants promise to maximize—that is a binding promise. For most firms the expectation is that the residual riskbearers have contracted for a promise to maximize long-run profits of the firm, which in turn maximizes the value of their stock.[11]

Note that this approach combines two elements—legal defaults and market expectations—into a normative claim that the legal default should reflect market expectations. It is worth teasing these two elements apart. The actual legal default in traditional jurisdictions like Delaware provides somewhat more flexibility than this passage would suggest. A recent attempt to restate the traditional default setting provides that:

> § 2.01 The Objective of a Corporation
> (a) The objective of a corporation is to enhance the economic value of the corporation, within the boundaries of law,
>
> > (1) (Common-law jurisdictions): for the benefit of the corporation's shareholders. In doing so, a corporation may consider:
> >
> > > (a) the interests of the corporation's employees;
> > > (b) the desirability of fostering the corporation's business relationships with suppliers, customers, and others;
> > > (c) the impact of the corporation's operations on the community and the environment;
> > > (d) ethical considerations related to the responsible conduct of business; and
> > > (e) other appropriate matters.[12]

As I have argued elsewhere, I think that this is an accurate description of the characteristics of the corporate form created by the Delaware statute as interpreted by Delaware cases.[13] Note

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[11] *Id.*

[12] RESTATEMENT OF THE LAW, CORPORATE GOVERNANCE § 2.01 (AM. L. INST., Council Draft No. 1, 2021).

[13] Rock, *For Whom Is the Corporation Managed in 2020?*, *supra* note 3, at 371–77.

several features. First, as with the E&F account, the (default) objective of a corporation is that it will be managed for the benefit of the residual beneficiaries, the shareholders. While there is great discretion given to the board of directors, that discretion is to be exercised for the benefit of the shareholders. The second sentence is thus an elaboration of the first. In enhancing the economic value of the corporation for the benefit of its shareholders, the corporation *may* consider other stakeholder interests. Here, the key words are "in doing so" and "may"; there is no free-standing legal obligation to consider the interests of non-shareholder constituencies.

Second, the legal description is framed in terms of "enhancing the economic value of the corporation" and not "maximiz[ing] the long-run profits of the firm." This is because the legal form—the corporation—is sufficiently flexible that, in its default form, it can accommodate a wide variety of enterprises including mutual companies (where the firm is owned by its customers). Vanguard's management firm, VGI, is owned by the investors in the Vanguard funds and is operated for the benefit of those funds.[14] In operating VGI, while the goal is to enhance the economic value of VGI (for its owners), doing so hardly requires maximizing the long-run profits of VGI.

On the other hand, in situations in which the interests of shareholders and other stakeholders diverge—such as in the sale of the corporation for cash—Delaware makes clear that the board's duty is quite close to the E&F characterization, namely, the board is obligated to seek "the highest value reasonably attainable."[15]

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[14] Letter from Tim Buckley, Managing Dir. & Chief Inv. Officer, The Vanguard Grp., Inc. & John Hollyer, Principal & Head of Risk Mgmt. Grp., The Vanguard Grp., Inc., to Secretariat, Fin. Stability Bd. 1 (Apr. 7, 2014), https://perma.cc/8SW2-7BT3.

[15] Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 182 (Del. 1986) ("The Revlon board's authorization permitting management to negotiate a merger or buyout with a third party was a recognition that the company was for sale. The duty of the board had thus changed from the preservation of Revlon as a corporate entity to the maximization of the company's value at a sale for the stockholders' benefit. . . . The directors' role changed from defenders of the corporate bastion to auctioneers charged with getting the best price for the stockholders at a sale of the company."); Mills Acquisition Co. v. Macmillan, Inc., 559 A.2d 1261, 1264 (Del. 1989) ("Our decision in *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, . . . 506 A.2d 173 (1986), requires the most scrupulous adherence to ordinary standards of fairness in the interest of promoting the highest values reasonably attainable for the stockholders' benefit."); Barkan v. Amsted Indus., Inc., 567 A.2d 1279, 1286 (Del. 1989) ("When it becomes clear that the auction will result in a change of corporate control, the board must act in a neutral manner to encourage the highest possible price for shareholders."); Paramount Commc'ns, Inc. v. QVC Network, Inc., 637 A.2d 34, 48 (Del. 1994) ("Since the Paramount directors had already decided to

Third, E&F's focus on market expectations adds an important supplement. As they discuss elsewhere in the book, shareholders are the only participants in the firm who, in the default setting, vote for directors, vote on mergers and sales of all or substantially all the assets, and vote on amendments to the certificate of incorporation.[16] When this governance structure is combined with the re-concentration of shareholding in the hands of institutional investors and hedge funds with a laser focus on share price, the reality in most firms will be precisely as E&F claim, namely, intense pressure to maximize the value of the stock or, alternatively stated, "total shareholder return."

The interaction of market practices and the characteristics of the legal form points to an important feature. While law defines the basic enterprise form—a form that has been more or less unchanged for 150 years or so[17]—its uses and specific characteristics will depend on business and market context. As the last 50 years of corporate governance has shown, the behavior of a corporation with genuinely dispersed ownership will be very different than a corporation with a controlling shareholder or a corporation with concentrated "bloc holders."

A. "Contracting" Out of the Default Settings

For E&F's contractarian framework, the default settings, however important, are just the beginning. The "consent" underpinnings of a contractarian approach require a meaningful opportunity to opt out of the default settings. The power of their "who cares?" attitude is that parties are able to tailor the corporate form to serve their own purposes.

There are three modes of opting out of the default shareholder-primacy construction of "corporate purpose," each of which is important: choosing a different state; choosing a different enterprise form; tailoring the default settings. While the opening quote emphasizes the latter, the first two are equally important to a contractarian view.

First, of course, is inter-state competition: different states offer different versions of corporate law that may appeal to entrepreneurs with different goals.[18] Many states have adopted some

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sell control, they had an obligation to continue their search for the best value reasonably available to the stockholders.").

[16] EASTERBROOK & FISCHEL, *supra* note 1, at 72–79.

[17] REINIER KRAAKMAN ET AL., THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 5–15 (3d ed. 2017).

[18] Kelli A. Alces, *Legal Diversification*, 113 COLUM. L. REV. 1977, 2022 (2013).

form of "multi-stakeholder constituency" statutes. These statutes include "modified shareholder-primacy" statutes that make clear that a board must consider the best interests of the shareholders and that it may consider other listed factors, usually including a generic "and other factors the board deems appropriate."[19] Other states adopt "level-playing field" statutes that list the factors a board *may* consider and ostensibly include the interests of shareholders as of equal rank with other listed constituencies.[20] Finally, a third type contains language making it clear that the Board may, without liability, completely sublimate some of the listed factors to others.[21]

Second, within a given state, entrepreneurs may choose among a menu of different enterprise forms, with different default settings, and different degrees and types of tailoring.[22] In addition to the basic general corporation, one can organize as an LLC, a general partnership, a limited partnership, a benefit corporation, or a number of other forms.[23]

These "alternative enterprise forms" largely embrace freedom of contracting, and thus make it very easy to commit to a "non-standard" corporate purpose. Indeed, the LLC provides so much freedom to tailor that one might agree with Peter Molk that we should think of it as the "default" enterprise form, with other forms as pre-set specifications for particular uses.[24]

The benefit corporation in particular provides a framework for making commitments to non-shareholder constituencies. Indeed, one might think of the benefit corporation as the standard form contract for firms that want to make enforceable commitments to non-shareholder stakeholders, or that wish to adopt a

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[19] ARIZ. REV. STAT. ANN. § 10–2702; GA. CODE ANN. § 14–2–202(b)(5); HAW. REV. STAT. § 414–221(b); IDAHO CODE ANN. §§ 30–1602, 30–1702; 805 ILL. COMP. STAT. 5/8.85; KY. REV. STAT. ANN. § 271b.12–210(4); ME. STAT. tit. 13–C, § 831(6); MISS. CODE ANN. § 79–4–8.30(f); NEB. REV. STAT. § 21–2102(a)(2); N.J. STAT. ANN. §§ 14a:6–1(2)–(3) (West); N.M. STAT. ANN. § 53–11–35(d); OHIO REV. CODE ANN. § 1701.59(f); R.I. GEN. LAWS § 7–5.2–8(a); S.D. CODIFIED LAWS § 47–33–4(1); TEX. BUS. ORGS. CODE ANN. §§ 21.401(b)– (e); WIS. STAT. § 180.0827; WYO. STAT. ANN. § 17–16–830(g).

[20] CONN. GEN. STAT. § 33–756(d); FLA. STAT. § 607.0830(3) ; MD. CODE. ANN., CORPS. & ASS'NS. § 2–104(b)(9); MASS. GEN. LAWS ch. 156D, § 8.30(a)(3); MINN. STAT. § 302A.251 subd. 5; MO. REV. STAT. § 351.347; OR. REV. STAT. § 60.357(5); N.D. CENT. CODE § 10–19.1–50(6); TENN. CODE. ANN. § 48–103–204 ; 11A V.S.A. § 8.30(a)(3).

[21] IND. CODE § 23–1–35–1(f) ; IOWA CODE § 491.101B(2) ; NEV. REV. STAT. § 78.138(4); N.Y. BUS. CORP. LAW § 717(b); 15 PA.C.S.A. § 1715(b).

[22] Rock, *For Whom Is the Corporation Managed in 2020?*, *supra* note 3, at 392.

[23] *Id.*

[24] *See generally* Peter Molk, *Do We Need Specialized Business Forms for Social Enterprise?*, *in* THE CAMBRIDGE HANDBOOK OF SOCIAL ENTERPRISE LAW 241–55 (Benjamin Means & Joseph W. Yockey eds., 2018).

"corporate purpose" that goes beyond "shareholder value." Moreover, because a firm may form as a benefit corporation originally, or convert into a benefit corporation midstream through a standard charter amendment, it is realistically available to any firm whose founders or whose shareholders desire to opt into it.[25]

Benefit corporations come in two flavors: those that follow the Model Benefit Corporation Legislation (MBCL); and Delaware's public benefit corporation (PBC) provisions. The MBCL requires that a benefit corporation "shall have a purpose of creating a general public benefit" and "may identify one or more specific public benefits that it is the purpose of the benefit corporation to create" and provides that the creation of those benefits are "in the best interests of the benefit corporation."[26] Directors, in considering the best interests of the corporation, "shall" consider the effects of any action on shareholders, employees, customers, communities, the environment and may be directed to consider additional constituencies.[27] They need not give priority to any particular interest unless "the benefit corporation has stated in its articles of incorporation its intention to give priority to certain interests or factor[s]. . . ."[28] Under MBCL Section 302, a publicly traded benefit corporation must, and a private benefit corporation may, have a "benefit director"[29] who shall be independent[30] and shall prepare an annual "compliance statement"[31] that includes an "assessment of the overall social and environmental performance of the benefit corporation against a third-party standard."[32] These obligations can be enforced through a "benefit enforcement proceeding"[33] brought directly by the benefit corporation or derivatively by a shareholder or group of shareholders holding at least two percent of the benefit corporation (or five percent of the benefit corporation's parent).[34]

By contrast, Delaware's Public Benefit Corporation provisions maintain the core goals—to commit to a "public benefit" beyond shareholder value, and "to operate in a responsible and

[25] 8 DEL. C. § 242; *Client Alert: Delaware Makes It Easier for Corporations to Become Public Benefit Corporations*, POTTER ANDERSON CORROON LLP (July 20, 2020), https://perma.cc/9S2S-47D3.

[26] MODEL BENEFIT CORP. LEGIS. §§ 201(a)–(b) (B LAB, Apr. 17, 2017).

[27] *Id.* at §§ 301(a)(1)–(2).

[28] *Id.* at § 301(a)(3).

[29] *Id.* at § 302(a)(1).

[30] *Id.* at § 302(b).

[31] *Id.* at § 302(c).

[32] *Id.* at § 401(a)(2).

[33] *Id.* at § 305(a).

[34] *Id.* at § 305(c).

sustainable manner"[35]—but, in keeping with Delaware's enabling approach, dispense with some of the mandatory provisions. Like in the MBCL,[36] a Delaware public benefit corporation "shall be managed in a manner that balances the stockholders' pecuniary interests, the best interests of those materially affected by the corporation's conduct, and the public benefit or public benefits identified in its certificate of incorporation."[37] Unlike the MBCL, however, there is no requirement for a "benefit director," even for publicly traded PBCs. Similarly, although there must be at least a biennial report to stockholders, it may, but need not, commit to a third-party standard.[38]

Unlike LLCs, LLPs and benefit corporations, the permitted tailoring of the traditional corporate form is more limited. How does E&F's statement, quoted above, fit with corporate law? Is E&F's normative goal of free "contracting out" actually part of the current legal structure?

Here, the debate over whether a new "benefit corporation" form was necessary is relevant. After all, if corporate law was as E&F suggested it should be, why would we need a new enterprise form? Why not just vary the terms of the existing form by "promising to pay half the profits to the employees rather than an equity investor" or declaring a "purpose to prefer loans to minority-owned businesses, or to third-world nations"? How would you do this?

A possibility—and what I expect E&F intended—would be to put a provision in the charter at formation.[39] The advantage of the charter is that it is publicly available, and its terms bind all future shareholders. The Delaware General Corporation Law, at 8 Del. C. § 102(b)(1), permits a charter to contain:

> Any provision for the management of the business and for the conduct of the affairs of the corporation, and any provision creating, defining, limiting and regulating the powers of the corporation, the directors, and the stockholders, or any class of the stockholders, or the governing body, members, or any class or group of members of a nonstock corporation; *if such provisions are not contrary to the laws of this State.* Any

[35] 8 DEL. C. § 362(a).
[36] MODEL BENEFIT CORP. LEGIS. §§ 301(a)(1)–(2).
[37] 8 DEL. C. § 362(a).
[38] 8 DEL. C. § 366(b)(3).
[39] If so, they would not be alone in this view. *See* AM. LAW INST., PRINCIPLES OF CORP. GOVERNANCE: ANALYSIS & RECOMMENDATIONS § 2.01 cmt. 6 (1994) (stating this would be valid and enforceable against future shareholders).

> provision which is required or permitted by any section of this chapter to be stated in the bylaws may instead be stated in the certificate of incorporation.[40]

Although I once thought that the generality of this language would allow one to opt out of the "economic" objective (and thus that the benefit corporation statute was largely unnecessary), it now seems to me that this is incorrect or at least doubtful.

The interpretive argument against the effectiveness of a charter provision that varies the default economic objective of a corporation would be two-fold. First, one would argue that § 102(b)(1) is best understood to be about tailoring the *management* of the business and the conduct of its affairs (all of which can be understood as being means by which the objective can be achieved), and not about changing the objective itself. Second, one would argue that such a provision is "contrary to the laws of the State." This is consistent with the key case interpreting the scope of § 102(b)(1), *Sterling v. Mayflower,* that makes clear that charter provisions are invalid if they "transgress a statutory enactment or a public policy settled by the common law or implicit in the General Corporation Law itself."[41] Fiduciary duties, that is, are part of the common law of Delaware and thus lie beyond the reach of a charter provision.

This argument becomes stronger in the wake of the enactment of the Public Benefit Corporation provisions, 8 Del. C. §§ 362 and 363, which specify how one forms a PBC or becomes one.[42] The enactment of the PBC provisions strengthens this argument because (a) the provisions would be unnecessary if you could opt out of the economic objective by charter provision and (b) they can be understood as an authoritative statement by the legislature on how one opts out of the economic objective.

III. PROTECTION AGAINST "SURPRISE."

One of the hardest issues for a contractarian framework is how to distinguish between anticipated evolution and unanticipated "surprises." What do E&F mean when they claim that "[i]f the venture at its formation is designed in the ordinary fashion—employees and debt investors holding rights to fixed payoffs and equity investors holding a residual claim to profits, which the other participants promise to maximize—that is a binding

[40] 8 DEL. C. § 102(b)(1) (emphasis added).

[41] Sterling v. Mayflower, 93 A.2d 107, 118 (Del. 1952).

[42] 8 DEL. C. §§ 362–63.

promise."[43] If, with E&F, we view the default setting of the corporate form in the traditional jurisdictions to be a commitment to manage the corporation for the benefit of the shareholders, when is a commitment to a broader corporate purpose a breach and when is it a permitted revision?

Most of the time, in most corporations, actions that benefit stakeholders can easily be justified as in the long-term interests of shareholders. When a disinterested board takes such actions and does so for the stated goal of enhancing long-term shareholder value, the business judgment rule will protect the decision and the directors.[44]

But not always. Sometimes, usually for some extrinsic reason, managers will "confess" to acting inconsistently with shareholders' interests. In these cases—e.g., *Dodge v. Ford* and, more recently, *eBay Domestic Holdings, Inc. v. Newmark* (the Craigslist case)—courts committed to the traditional view of "shareholder primacy" will protect the original bargain.[45] For our purposes, the Craigslist case provides a nice example of this sort of enforcement. eBay owned a 28.4% stake in Craigslist.[46] The other two stockholders were Craig Newmark, the founder of Craigslist, and Jim Buckmaster, its CEO.[47] Worried about eBay's (explicitly permitted) efforts to launch an online classified ad service, Newmark and Buckmaster first tried to convince eBay to sell its shares back to Craigslist.[48] When eBay refused, Craigslist adopted a shareholder rights plan that restricted eBay's ability to sell its shares to a third party.[49] The only justification that Craig and Jim offered was a concern that their heirs might sell their shares to eBay which would "fundamentally alter craigslist's values, culture and business model, including departing from [craigslist's] public service mission in favor of increased monetization of craigslist."[50] Interestingly, Craig and Jim seemed to have stubbornly refused to justify the adoption of the shareholder rights plan as necessary for the long-term financial success of the enterprise, an argument

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43 EASTERBROOK & FISCHEL, *supra* note 1, at 36.

44 Rock, *For Whom Is the Corporation Managed in 2020?*, *supra* note 3, at 375.

45 Dodge v. Ford Motor Co., 204 Mich. 459, 507 (1919) ("A business corporation is organized and carried on primarily for the profit of the stockholders."); eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 35 (Del. Ch. 2010).

46 eBay Domestic Holdings, Inc., 16 A.3d at 11.

47 *Id.* at 6.

48 *Id.*

49 *Id.*

50 *Id.* at 32.

they, or their lawyers, could have made in light of eBay's efforts to compete.

As with other "confession" cases,[51] the court had little choice but to enjoin the plan.[52] In language that almost overlaps with E&F, Chancellor Chandler held that:

> Jim and Craig did prove that they personally believe craigslist should not be about the business of stockholder wealth maximization, now or in the future. As an abstract matter, there is nothing inappropriate about an organization seeking to aid local, national, and global communities by providing a website for online classifieds that is largely devoid of monetized elements. Indeed, I personally appreciate and admire Jim's and Craig's desire to be of service to communities. The corporate form in which craigslist operates, however, is not an appropriate vehicle for purely philanthropic ends, at least not when there are other stockholders interested in realizing a return on their investment. Jim and Craig opted to form craigslist, Inc. as a for-profit Delaware corporation and voluntarily accepted millions of dollars from eBay as part of a transaction whereby eBay became a stockholder. Having chosen a for-profit corporate form, the craigslist directors are bound by the fiduciary duties and standards that accompany that form. Those standards include acting to promote the value of the corporation for the benefit of its stockholders. The "Inc." after the company name has to mean at least that. Thus, I cannot accept as valid for the purposes of implementing the Rights Plan a corporate policy that specifically, clearly, and admittedly seeks *not* to maximize the economic value of a for-profit Delaware corporation for the benefit of its stockholders—no matter whether those stockholders are individuals of modest means or a corporate titan of online commerce. If Jim and Craig were the only stockholders affected by their decisions, then there would be no one to object. eBay, however, holds a significant stake in craigslist, and Jim and Craig's actions affect others besides themselves.[53]

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51 Leo J. Strine, Jr., *The Dangers of Denial: The Need for a Clear-Eyed Understanding of the Power and Accountability Structure Established by the Delaware General Corporation Law*, 50 WAKE FOREST L. REV. 761, 775–76 (2015).

52 eBay Domestic Holdings, Inc., 16 A.3d at 34.

53 *Id.*

But, for our purposes, the Craigslist case may be too easy: no efforts were made to opt out of the traditional corporate objective. Let's make the hypo more interesting by using E&F's example: suppose a firm suddenly acquires a newspaper and then, by charter amendment, declares that it is no longer primarily interested in profit to the extent that pursuit of profits interferes with the mission of the newspaper. Would the equity investors have a legitimate complaint for breach of contract? Would this constitute a "surprise" that courts would block? Or would it be effective?

With the enactment of the PBC provisions, the statute provides a straightforward path. Suppose that the corporation amended its certificate of incorporation to become a PBC and adopted as its public benefit "the operation of a newspaper for the benefit of surrounding communities." This is likely a permitted public benefit under 362(b).[54] Once the firm "converts," 8 Del. C. § 362(a) requires that the corporation "shall be managed in a manner that balances the stockholders' pecuniary interests, the best interests of those materially affected by the corporation's conduct, and the public benefit or public benefits identified in its certificate of incorporation."[55]

Given these statutory provisions, the amendments would be effective in transforming the purpose of the corporation and, however shocking some shareholders might find it, it would not be an improper surprise: all investors are presumed to understand how one amends a certificate of incorporation. For corporations formed after the PBC amendment provisions were adopted, the "consent" argument is clear. For corporations formed before the relevant PBC provisions were adopted, 8 Del. C. § 394 establishes the retroactive effect of those changes, at least in the absence of any express provision in a charter.[56]

But E&F were writing well before the PBC provisions were added to the statute.[57] Suppose, instead, that a firm simply inserted a provision in the charter pursuant to 8 Del. C. §§ 101(b) and 102(b)(1), (without proclaiming itself a PBC)? Here, the first question would be whether such a provision would have the effect of changing the directors' fiduciary duties. A shareholder

[54] 8 DEL. C. § 362(b) ("'Public benefit' means a positive effect . . . on . . . communities . . . including effects of an artistic, charitable, cultural, economic, educational, environmental, literary, medical, religious, scientific or technological nature.").

[55] *Id.* at § 362(a).

[56] 8 Del. C. § 394; R. FRANKLIN BALOTTI ET AL., DELAWARE LAW OF CORPORATIONS & BUSINESS ORGANIZATIONS § 8.2 (4th ed. 2022).

[57] Sections 362 and 363 were made effective Aug. 1, 2015 and July 16, 2020, respectively.

challenge would point to the statutory language in § 101 limiting purposes to "lawful" purposes,[58] and the permission in § 102(b)(1) to adopt a "provision for the management of the business and for the conduct of the affairs of the corporation" only "if such provisions are not contrary to the laws of this State."[59] In both cases, one would argue that the "nonstandard" provisions would be "contrary to the laws of the State" in purporting to change the objective or the fiduciary duties of directors. Just as a charter provision that purported to eliminate the duty of care or loyalty would be invalid, the argument would go, so too would a charter provision that changed the corporate objective in this way.

This is consistent with the key case interpreting the scope of § 102(b)(1), *Sterling v. Mayflower,* which makes clear that charter provisions are invalid if they "transgress a statutory enactment or a public policy settled by the common law or implicit in the General Corporation Law itself."[60] It is also consistent with the arguments made for contractual freedom in LLCs (in *contrast* to corporations) where there is, by design, much greater scope for modifying fiduciary duties.[61]

The ease with which the PBC provisions now allow opting out of "shareholder primacy" is quite striking and raises an interesting problem for the E&F analysis. As a formal matter, the rules for amending the certificate of incorporation are part of the background features of the "corporate contract."[62] Yet, I tend to think that they will be uncomfortable with that conclusion, in part because it leaves so much open to change. Under this system, a controlling shareholder could unilaterally opt out of shareholder primacy by appointing directors who would recommend a charter amendment and casting its votes in favor. Moreover, this would be true whether or not the controlling shareholder was in control when non-controlling shareholders bought their shares.

By contrast, the original Delaware PBC provisions fit more comfortably with the E&F view. Originally, conversion to a PBC required a two-thirds vote of shareholders and provided appraisal rights to dissenting shareholders.[63] This provision could, indeed,

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[58] 8 DEL. C. § 101(b).

[59] 8 DEL. C. § 102(b)(1).

[60] Sterling v. Mayflower, 93 A.2d 107, 118 (Del. 1952).

[61] Molk, *supra* note 24, at 247.

[62] *See* 8 DEL. C. § 242.

[63] Cydney Posner, *In a First, a Traditional Corporation Converts to a PBC—Will It Spark a Trend?*, COOLEY PUBCO (Jan. 25, 2021), https://perma.cc/V95U-5U3L ("Originally, the shareholder voting requirement for a corporation to become a PBC was set at 90% of the outstanding shares; that was reduced to 2/3 of the outstanding shares in 2015—still a

protect a shareholder's interest in a corporation run for the benefit of shareholders against unanticipated abandonment of the profit objective.

But the evolution of the PBC provisions raises a further issue for the E&F analysis: what to make of statutory modifications that change the ground rules? With the most recent evolution of Delaware corporate law, it no longer provides much protection against surprises of this sort. From the point of view of firms incorporating in 1992, it was likely inconceivable that Delaware would allow opting out of shareholder primacy by a simple charter amendment. Without that as a realistic possibility, why would any parties forming a corporation insert a provision that required a supermajority for later opting out of shareholder primacy? And, having not inserted a provision, under 8 Del. C. § 394, they are bound by later amendments of the statute.[64]

Here, it seems to me, we come to an interesting unstated feature of their contractarian view: it is nested within a particular market context. Despite the legal possibility of opting out of shareholder primacy by charter amendment, we do not see waves of corporations abandoning shareholder primacy to become PBCs. Why not? Well, for the reasons that E&F suggest: firms need to raise equity capital; equity investors generally want the firm to be run for their ultimate benefit; managers' interests are aligned with those of shareholders through compensation structures; and shareholders have a variety of mechanisms to rid themselves of directors who are insufficiently attentive to share value. Put differently, it seems that the main protections that shareholders have against unexpected departures from shareholder primacy are not "contractual" after all but based on their governance rights.

IV. So What Does ESCL Tell Us About the "Corporate Purpose" Debate?

Read against the current public and academic debate about "corporate purpose,"[65] there are a variety of insights that we can draw from E&F's treatment 30 years ago.

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rather high hurdle, especially if the company is already public. Then in 2020, the 2/3 voting requirements was eliminated, making it easier to convert a traditional corporation to a PBC or a PBC to a traditional corporation. Now, only the standard shareholder vote provisions are applicable—generally a vote of a majority of the outstanding shares.").

64 8 Del. C. § 394.

65 *See generally* Rock, *For Whom Is the Corporation Managed in 2020?*, *supra* note 3.

First, their deflationary intuition—captured in the "who cares?" reaction—is deeply correct. While much hot air and ink have been, and will continue to be, expended, it is not clear that the question actually matters beyond its symbolic significance.[66] The power structure created by corporate law—in which shareholders are the only stakeholders with any significant power—remains unchanged. With the reconcentration of shareholding in the hands of institutional investors and hedge funds, shareholders have the real power to use those levers to discipline directors and regularly do so.[67] As a result, whatever Larry Fink says about the importance of corporate purpose (either as an independent good or as a key element to superior financial performance), directors know that shareholders and their agents (including BlackRock portfolio managers) demand performance measured by financial metrics. Until and unless shareholders or those intermediaries investing on behalf of the ultimate beneficial owners change their focus on financial performance, nothing significant is likely to change.

Second, E&F's "contractarian" intuition has substantial purchase here. We now have a wide menu of enterprise forms or, in an E&F vein, alternative standard form contracts.[68] In addition to the basic corporation (as it exists in traditional states and the alternative specification in stakeholder jurisdictions), we now have two widely used forms that explicitly embrace freedom of contracting: LLCs and LPs. In addition, there are now a variety of forms specifically designed for various sorts of "social enterprises": benefit corporations (in the MBCL and Delaware versions), the social purpose corporation (SPC), the low-profit limited liability company (L3C), the benefit limited liability company (BLLC), and the statutory public benefit limited partnership (SPBLP).[69] This rich menu of enterprise forms supports the E&F intuition that maintaining the distinctive properties of each enterprise form will facilitate optimal contracting, reduce transaction costs, and reduce the cost of capital.

Third, to the extent that arguments about "corporate purpose" are attempts to revise our understanding of the basic

[66] Marcel Kahan & Edward Rock, *Symbolic Corporate Governance Politics*, 94 B.U. L. REV. 1997 (2014).

[67] Marcel Kahan & Edward Rock, *Index Funds and Corporate Governance: Let Shareholders Be Shareholders*, 100 B.U. L. REV. 1771 (2020).

[68] Rock, *For Whom Is the Corporation Managed in 2020?*, *supra* note 3, at 394.

[69] *See generally* Sydney Forrest et al., *The State of Social Enterprise and the Law, 2020–2021*, GRUNIN CTR. FOR L. & SOC. ENTREPRENEURSHIP AT N.Y.U. SCH. OF L., https://perma.cc/QE9K-XENC.

properties of the corporate form as a means of changing how directors and shareholders conceive of their appropriate social and economic roles—e.g., to become more attentive to various stakeholder interests—the E&F of ESCL would push back vigorously for at least two reasons: doing so interferes with the settled understandings and expectations of participants in firms that have organized as corporations, and changing the "default settings" or "off-the-rack terms" to prioritize stakeholder interests is to adopt an aspirational structure in place of "the operational assumption of successful firms."[70]

Fourth, pushing in the other direction, E&F offer a regulatory carrot for the choice of wealth as the maxim of corporate governance, namely, that:

> [S]ociety may change corporate conduct by imposing monetary penalties. These reduce the venturers' wealth, so managers will attempt to avoid them. A pollution tax, for example, would induce the firm to emit less. It would behave as if it had the interests of others at heart.[71]

This is a really important insight that has largely been absent in the current debate over the virtues and vices of "shareholder primacy." Keeping managers focused on maximizing long-term share value makes classic regulation *more* effective than a more stakeholder-oriented approach because it amplifies the effects of financial sanctions.

E&F's focus on the core "private law" aspects of corporate law—their "contractarian" perspective—rejects as misguided many (most? all?) of the "public law" regulatory initiatives to protect investors and to make corporations into good citizens. While corporate law has always straddled the line between private and public law, we neglect its private law aspects at our peril. While, for me, ESCL is rarely the last word on any corporate law issue, it often is the first word. Few books have had that sort of influence on my thinking, and I am grateful they wrote it.

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70 EASTERBROOK & FISCHEL, *supra* note 1, at 36.

71 *Id.* at 37.