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Citation: 62 UCLA L. Rev. Discourse 87 2014



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Mon Aug 17 04:58:56 2015

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CORPORATE GOVERNANCE THEORY AND REVIEW OF BOARD DECISIONS

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Prevailing theories of corporate governance advance strikingly different claims regarding the desirable balance of power within, and underlying purpose of, the enterprise. Accordingly, they prompt strikingly different predictions regarding how, and subject to what standards, shareholders may challenge board decisions.

Shareholder Primacy favors strong shareholder powers and exclusive focus on their interests.¹ This conception leads one to predict ample opportunity not merely to second-guess board decisions procedurally but to interfere with them substantively.

Director Primacy agrees that generating shareholder wealth is paramount but favors the efficiency of board-centric governance.² This conception leads one to predict no opportunity for shareholder interference with substantive board decisions, but perhaps limited opportunity to second-guess them procedurally, with restrained judicial review distinguishing the latter from the former.

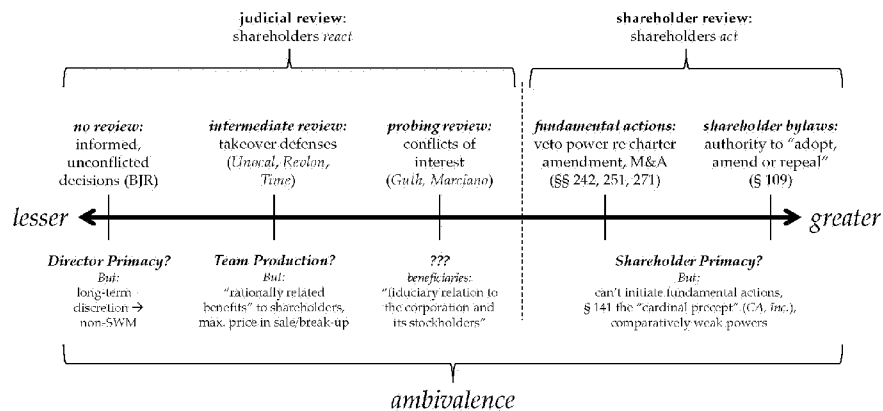
Team Production resembles Director Primacy in favoring board-centric governance but predicates this on a different conception of corporate purpose, styling the board as a “mediating hierarch” charged with coordinating various constituencies’ contributions to production. This role requires subordination of each constituency’s interests to a broader duty owed to the enterprise.³ This conception naturally leads one to predict sharply constrained opportunity for shareholders to challenge board decisions and a correlatively skeptical judicial posture in the face of such efforts.

How do these theories and predictions fare descriptively? The figure below arrays illustrative forms of review under Delaware corporate law from lesser to greater intensity. These range from preclusion of substantive review under the business judgment rule; to intermediate review of takeover defenses, involving a proportionality inquiry permitting target boards to consider nonshareholder interests as long as rationally related shareholder benefits can be

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1. See generally Lucian A. Bebchuk, *The Myth of the Shareholder Franchise*, 93 VA. L. REV. 675 (2007).
 2. See generally Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547 (2003).
 3. See generally Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247 (1999).

identified; to probing review of conflicts, requiring directors to establish the transaction's fairness; to limited forms of self-help, permitting shareholders to respond directly to disagreeable board conduct without resort to courts. The latter category includes veto power over board-proposed fundamental actions and authority to adopt, amend or repeal bylaws—raising the theoretical possibility of repealing board-adopted bylaws or otherwise constraining board power.

FIGURE 1. Intensity of Review (Delaware) and Theoretical Implications



On balance, none of the foregoing theories provides a compelling descriptive account.⁴

Director Primacy favors board discretion yet struggles with the board's practical capacity to deviate from shareholder interests and the shareholders' capacity for autonomous action.

Team Production favors the combination of strong board powers with express regard for nonshareholders in takeovers. Yet, discretion to consider nonshareholders falls well short of the stakeholder mandate that a true mediating hierarch requires. The shareholders' capacity to discipline the board through autonomous action further contradicts the team production account.

Shareholder Primacy encounters challenges across the spectrum. Substantial board discretion plainly contradicts the shareholder-centric ideals of power and purpose alike, and the shareholders' capacity for autonomous action—though real—remains sharply circumscribed. Shareholders may veto fundamental actions but cannot initiate them, and emerging case law suggests

4. See generally CHRISTOPHER M. BRUNER, CORPORATE GOVERNANCE IN THE COMMON-LAW WORLD: THE POLITICAL FOUNDATIONS OF SHAREHOLDER POWER 36–65 (2013).

that board governance authority trumps the shareholders' bylaw authority when the two substantively conflict.

Ultimately, there is no clear winner—a reality crystalized in Delaware's ambiguous formulation of fiduciary duty, owed “to the corporation and its stockholders” simultaneously.⁵ This formulation remains the great Rohrschach of our field—whatever one wants to think about corporate purpose can be found here.

The normative question is whether strict adherence to any pure theory would prove beneficial. I think not. The social and economic roles of the public corporation are so diverse and far-reaching that we cannot expect any singular conception to serve us well in all contexts. Delaware corporate law's ambivalence regarding power and purpose reflects the need for flexibility to tailor our working theory of the corporation—and the standards by which board decisions are judged—to varying circumstances.

If any single criterion can explain what we observe, it is sustainability—even if judges rarely acknowledge it. Corporate law is in the business of sustaining business and that criterion will ultimately trump any single constituency's claims to primacy or decisionmaking authority—no matter how theoretically compelling those claims may otherwise seem.

5. Guth v. Loft, 5 A.2d 503, 510 (Del. 1939).