

THE LEGAL PRIMACY NORM

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Abstract

Corporate law scholarship revolves around two polar conceptions, known as “shareholder primacy” and “corporate social responsibility.” This Article takes the literature in a new direction, arguing that the current dichotomy misses a crucial aspect of corporate law: its norm of legal primacy. Any pursuit of profit, by the corporation, is legally permitted only within the bounds of full compliance with non-corporate positive law. When the corporation acts unlawfully, corporate law provides a powerful, and until now undertheorized, set of remedies against its fiduciaries and shareholders.

As this Article demonstrates, the most effective way to promote socially desirable corporate behavior is by utilizing the legal primacy devices that corporate law already offers, while continuing to strengthen non-corporate law. Connecting legal primacy with corporate practice, this Article discusses a number of doctrines, some of which have recently become high-profile topics of litigation and scholarship: the fiduciary duty of good faith; directors’ oversight duties; the mandatory limits on dividends and buybacks; the shift in corporate purpose in the vicinity of insolvency; the seniority of preferred and trust shareholders; and the judicial dissolution of law-breaking corporations. The analysis offered in this Article can help shape the law to better protect stakeholders (without departing from rule of law principles, or the rights that entities and shareholders do have), and chart a more nuanced trajectory for broader discourse on business law, private law, and public regulation.

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INTRODUCTION

In his well-known 1970 article, published in the *New York Times Magazine*, Milton Friedman argued that the “responsibility [of a corporate executive] is to conduct the business in accordance with [owners’] desires, which generally will be to make as much money as possible.”¹ While not uncontroversial at the time it was made,² this statement set the stage for the rise of an eminent school of thought in modern corporate law: the shareholder primacy view, according to which “managers of the corporation should be charged with the obligation to manage the corporation in the interests of its shareholders.”³ Consequently, “[t]he subject of most corporate law scholarship is the conflict of interests between managers . . . and shareholders,”⁴ where the

1. Milton Friedman, *A Friedman Doctrine—The Social Responsibility of Business Is to Increase Its Profits*, N.Y. TIMES MAG. (Sept. 13, 1970), <https://www.nytimes.com/1970/09/13/archives/a-friedman-doctrine-the-social-responsibility-of-business-is-to.html> [https://perma.cc/7A6M-AGEN].

2. See, e.g., David Gindis, *On the Origins, Meaning and Influence of Jensen and Meckling’s Definition of the Firm*, 72 OXFORD ECON. PAPERS 966, 973–76 (2020) (surveying the public debate over corporate social responsibility in the 1970s).

3. Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 441 (2001).

4. Zohar Goshen & Richard Squire, *Principal Costs: A New Theory for Corporate Law and Governance*, 117 COLUM. L. REV. 767, 775 (2017).

literature is organized around the concept of “agency costs.”⁵ An important challenge to this view comes from the corporate social responsibility (CSR) approach, under which “fiduciaries . . . may . . . prioritize the interests of other stakeholders.”⁶ These approaches are generally perceived by scholars as the only two options corporate law has to offer.⁷ Since 2019, the shareholder–stakeholder debate has become the central topic in corporate law scholarship.⁸

Crucially, however, Friedman’s argument did not end there. He added that the pursuit of profit must take place “*while conforming to the basic rules of the society*, both those embodied in law and those embodied in ethical custom.”⁹ Somewhat puzzlingly, the vast majority of scholarly and policy debates in corporate law over the last five decades have focused on the first prong only—the “profit” part, both in terms of it being the corporation’s objective (or not, as stakeholderists claim), and in terms of how that objective can best be achieved (where the agency costs literature does most of its work).¹⁰ Yet, there has never been anything to suggest that the second prong—the “lawful” part—is in any way less significant.

This Article makes an original, yet straightforward argument: corporate law—in its current, descriptive state, and without any need for additional social responsibility reform—*does* place stakeholders at its very center. It does so in a specific way: by demanding strict compliance with positive law, namely those areas that lie *outside* of corporate law itself (such as tort, employment, or environmental law). Corporate law achieves this through a well-settled array of concepts and doctrines, examined in detail throughout this Article.

As a result, this Article argues that the most effective way to promote socially desirable corporate behavior is by, first, utilizing and improving upon those existing doctrines; and, second, continuing to strengthen the

5. See, e.g., J.B. Heaton, *Corporate Governance and the Cult of Agency*, 64 VILL. L. REV. 201, 207 (2019) (“A huge amount of scholarship in corporate law and financial economics assumes the existence of agency costs[,] losses that result from expenditures to prevent managerial disloyalty plus the loss of shareholder value from disloyalty that occurs despite these expenditures.”).

6. Dorothy S. Lund & Elizabeth Pollman, *The Corporate Governance Machine*, 121 COLUM. L. REV. 2563, 2565 (2021).

7. See, e.g., William T. Allen, *Our Schizophrenic Conception of the Business Corporation*, 14 CARDOZO L. REV. 261 *passim* (1992) (contrasting the “property conception” (shareholderism) with the “entity conception” (stakeholderism)); Leo E. Strine, Jr., *The Dangers of Denial: The Need for a Clear-Eyed Understanding of the Power and Accountability Structure Established by the Delaware General Corporation Law*, 50 WAKE FOREST L. REV. 761, 773 (2015) (stating that in his article, “Chancellor Allen dilated on the two major traditions in American corporate law”).

8. See, e.g., Jill E. Fisch & Steven Davidoff Solomon, *Should Corporations Have a Purpose?*, 99 TEX. L. REV. 1309, 1309 (2021).

9. Friedman, *supra* note 1 (emphases added).

10. See *infra* Part III.

(non-corporate) laws that bind every corporation. Although this is very different from the existing conception of CSR, this Article demonstrates that such an approach *better* protects the interests of employees, consumers, creditors, and the environment, while also preserving the legitimate claims of corporations and shareholders who do comply with their legal duties.

This Article joins the works of several scholars who recently offered similar observations, stating, for example, that “the promise of corporate governance may have been overrated, . . . [as it] may crowd out potentially more effective responses to the problems at hand”;¹¹ that the tools “more effective in directly helping weaker constituencies”¹² are those external to corporate law; and that “to the extent that reliance on [corporate law reform] reduces support for government intervention, support for [such reform] might prove not only ineffective but also actively damaging.”¹³ Yet, this Article is the first to structurally explain how corporate law itself, *in concert* with non-corporate law, strongly defends stakeholder interests. This Article is also the first to describe how the compliance function can resolve the prevalent, but misguided, dichotomy between shareholder primacy and corporate social responsibility, charting a more nuanced, more productive, and fairer trajectory for corporate law and scholarship.

To begin with, because corporate law mandates that corporations are separate legal persons,¹⁴ corporations (like all other people in society) are required to obey any and all laws, without exception.¹⁵ This requirement is well-recognized when it arises in *non-corporate* law: for example, corporations must meet their contractual obligations, comply with

11. Mariana Pargendler, *The Corporate Governance Obsession*, 42 J. CORP. L. 359, 402 (2016).

12. Matteo Gatti & Chrystin Ondersma, *Stakeholder Syndrome: Does Stakeholderism Derail Effective Protections for Weaker Constituencies?*, 100 N.C. L. REV. 167, 171 (2021).

13. Roberto Tallarita, *The Limits of Portfolio Primacy*, 76 VAND. L. REV. (forthcoming 2023) (manuscript at 52), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3912977 [<https://perma.cc/F5VX-LTQX>].

14. *See, e.g.*, REINIER KRAAKMAN, JOHN ARMOUR, PAUL DAVIES, LUCA ENRIQUES, HENRY HANSMANN, GERARD HERTIG, KLAUS HOPT, HIDEKI KANDA, MARIANA PARGENDLER, WOLF-GEORG RINGE & EDWARD ROCK, *THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH* 5–8 (3d ed. 2017) (discussing “[l]egal personality” as a “core structural characteristic[]” of the corporation); EVA MICHELER, *COMPANY LAW: A REAL ENTITY THEORY* (2021); ERIC W. ORTS, *BUSINESS PERSONS: A LEGAL THEORY OF THE FIRM* (2013); Mariana Pargendler, *Regulatory Partitioning as a Key Function of Corporate Personality*, in *RESEARCH HANDBOOK ON CORPORATE PURPOSE AND PERSONHOOD* 263 (Elizabeth Pollman & Robert B. Thompson eds., 2021).

15. *See, e.g.*, Sean J. Griffith, *Agency, Authority, and Compliance*, in *THE CAMBRIDGE HANDBOOK OF COMPLIANCE* 673, 673 (Benjamin van Rooij & D. Daniel Sokol eds., 2021) (“Law is *what you must do*—the rules and regulations originating from the sovereign, transgression of which may lead to deprivation of property or, in some cases, liberty.” (emphasis added)).

environmental law, or, in some cases, face liability under criminal law.¹⁶ Following their involvement in the opioid epidemic, many pharmaceutical companies now stand trial.¹⁷ Even when a corporation enters bankruptcy, it must pay whatever it has left to its stakeholders, whose claims always rank above those of shareholders.¹⁸

As this Article explains, there is an additional, and until now undertheorized, layer to the requirement of legal obedience. That layer—which this Article calls the *legal primacy norm*—arises within corporate law itself. It is enforced by corporate law courts, imposes fiduciary liability on corporate directors and officers, and places a hard limit on the rights of the archetypal corporate law actor—shareholders—who can only lawfully get what is left after the corporation meets (or as long as it can meet) *all* of its other obligations.

Indeed, the phrase “shareholder primacy” is counterfactual: corporate law makes shareholders the most junior, *subordinated* claimants toward the corporation. Even the for-profit corporation’s purpose is not merely the pursuit of profit, but the “*lawful* pursuit of profit.”¹⁹ Many additional canons of corporate law support the legal primacy norm. No one may establish a corporation for an unlawful goal.²⁰ No shareholder majority can ever declare (in a shareholder meeting, or in the corporation’s formative documents) that the entity may breach any of its non-corporate legal duties.²¹ Shareholders’ power to appoint directors—epitomized by

16. See, e.g., Mihailis E. Diamantis, *Clockwork Corporations: A Character Theory of Corporate Punishment*, 103 IOWA L. REV. 507 (2018).

17. See *County of Summit v. Purdue Pharma L.P.* (*In re Nat’l Prescription Opiate Litig.*), No. 1:17-md-2804, 2018 U.S. Dist. LEXIS 213657, at *1–55, *113 & *passim* (N.D. Ohio Dec. 19, 2018) (indicating that the vast majority of defendants are corporate entities; denying motions to dismiss the consolidated civil action; discussing plaintiffs’ non-corporate law causes of action, grounded in areas such as tort law and unjust enrichment).

18. See, e.g., *Case v. L.A. Lumber Prods. Co.*, 308 U.S. 106, 115–19 (1939) (upholding “the precedence to be accorded creditors over stockholders in reorganization plans” and citing multiple cases to that effect); *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 203–05 (1988) (reaffirming *Los Angeles Lumber*); Jeff Sommer, *Hertz: And Now for Something Completely Worthless*, N.Y. TIMES (June 17, 2020), <https://www.nytimes.com/2020/06/17/business/hertz-bankruptcy-stock-sale.html> [<https://perma.cc/RJ4P-EUFZ>] (“[I]n bankruptcy . . . , creditors have a higher claim on assets than shareholders do. By the time the creditors have been paid a fraction of what they are owed, there may be nothing left for shareholders.”).

19. Asaf Raz, *A Purpose-Based Theory of Corporate Law*, 65 VILL. L. REV. 523 *passim* (2020) (emphasis added).

20. See, e.g., DEL. CODE ANN. tit. 8, § 101(b) (2022) (“A corporation may be incorporated or organized under this chapter to conduct or promote any lawful business or purposes . . .”).

21. See, e.g., Robert H. Sitkoff, *Trust Law as Fiduciary Governance Plus Asset Partitioning*, in *THE WORLDS OF THE TRUST* 428, 436–37 (Lionel Smith ed., 2013) (“[T]he governing organizational documents of a corporation, limited liability company or partnership [cannot] validly foreclose recovery against the organization’s property by a third party in satisfaction of the third party’s claim against the organization . . . [I]n creating what is in effect

the phenomenon of shareholder activism—is subject to the requirement of lawful behavior by all involved parties.²² Although directors and officers can cause the corporation to act unlawfully (as many corporations undoubtedly do), they will also be exposed to legal sanction for doing so.²³ Well-entrenched fiduciary-protective devices, such as the business judgment rule and Section 102(b)(7),²⁴ do not apply when the legal primacy norm has been violated.²⁵ Put simply, breaking the law is outside the broad range of open-ended adventures that corporations are meant to pursue.²⁶

Importantly, there are real penalties when someone tries to ignore these facts. The legal primacy norm materializes through a set of legal tools, some of which have recently moved to the center of corporate law adjudication and scholarship. Part II below identifies six such doctrines: the fiduciary duty of good faith, which broadly requires that fiduciaries not act “with the intent to violate applicable positive law”;²⁷ directors’ oversight duties, epitomized by Delaware’s *Caremark*²⁸ doctrine; the mandatory limits on dividends and buybacks; the change in corporate purpose when a corporation nears or enters insolvency; the seniority of preferred shareholders and trust shareholders; and the judicial dissolution of law-breaking corporations. So far, these devices have been studied separately, but, as this Article demonstrates, they are all facets of the same underlying norm. The fact that legal primacy manifests in (at least)

an artificial person separate from the organization’s insiders, the law requires this artificial person to be responsible for claims against it by third parties.”).

22. See, e.g., *In re Nine W. LBO Sec. Litig.*, 505 F. Supp. 3d 292 (S.D.N.Y. 2020) (partly denying motion to dismiss a fiduciary duty complaint against former directors of a corporation, for actions that were taken in the interest of a private equity investor, and which caused the corporation to become insolvent).

23. See, e.g., Elizabeth Pollman, *Corporate Oversight and Disobedience*, 72 VAND. L. REV. 2013, 2017 (2019) (“Delaware courts have prioritized giving directors broad latitude to take business risk by *drawing a line at legal risk* . . .” (emphasis added)).

24. Tit. 8, § 102(b)(7) (allowing for the waiver of monetary remedies for breaches of the duty of care by directors of a Delaware corporation, if a provision to that effect is placed in the corporation’s charter).

25. See *infra* Sections II.A–C (explaining that directors are not immunized from liability—under either the business judgment rule or Section 102(b)(7)—in cases of bad faith breach of law, violation of the *Caremark* doctrine, or breach of the mandatory limits on dividends and buybacks, respectively).

26. See Asaf Raz, *Mandatory Arbitration and the Boundaries of Corporate Law*, 29 GEO. MASON L. REV. 223, 267–77 (2021) (discussing the open-endedness principle as a unifying theory for corporate law).

27. *Stone v. Ritter*, 911 A.2d 362, 369 (Del. 2006) (quoting *Brehm v. Eisner (In re Walt Disney Co. Derivative Litig.)*, 906 A.2d 27, 67 (Del. 2006) (quoting *In re Walt Disney Co. Derivative Litig.*, 907 A.2d 693, 755 (Del. Ch. 2005))).

28. *In re Caremark Int’l Inc. Derivative Litig.*, 698 A.2d 959 (Del. Ch. 1996) (allowing claims against directors for failing to implement a reporting system and monitor the corporation’s activities).

six different, practically salient ways points to corporate law's structural commitment to rule of law principles and stakeholders' rights.

At this point, many CSR advocates, while possibly agreeing that legal primacy differs from shareholder primacy, will likely object to its broad reliance on the concept of positive law,²⁹ and to the distinction made here between different *areas* of law, particularly corporate law and regimes external to it.³⁰ After all, the point of CSR is precisely to demand corporate behavior that goes “beyond compliance with the law,”³¹ while doubting the very possibility that law can effectively protect stakeholders.³² This Article, however, explains why CSR advocates should fundamentally reconsider these ideas.

That is so for two main reasons. The first has to do with rule of law principles, and the logical fact that no person can be legally required to obey more than the sum of their legal obligations.³³ Corporations and shareholders have some rights, not just duties, and are entitled to keep what remains after they *do* meet their obligations to others. While corporations are increasingly (and often desirably) disciplined by *non-legal* means, such as reputation, consumer and employee preferences, and the capital markets—most prominently, with the rise of environmental,

29. See, e.g., Strine, *supra* note 7, at 790 (“For those who decry [certain behaviors by corporations], the solution must come from . . . bodies of positive law that constrain corporate behavior, . . . and cannot rationally rest on calls for corporate directors to ‘be patriotic.’”). For discussion of the term “positive law” as used in this Article, see Raz, *supra* note 19, at 529 n.24.

30. The distinction between the corporation's internal and external spheres was, for example, the topic of a classic work in law and economics, R. H. Coase, *The Nature of the Firm*, 4 *ECONOMICA* 386 (1937). For further development of Coase's insights in legal terms, see Charles R. T. O'Kelley, *Coase, Knight, and the Nexus-of-Contracts Theory of the Firm: A Reflection on Reification, Reality, and the Corporation as Entrepreneur Surrogate*, 35 *SEATTLE U. L. REV.* 1247, 1260 (2012) (“[T]he corporation encompasses the contractual and legal relations between, and the contractual and legal responsibilities of, the shareholders, directors, and officers; it is these relations and responsibilities that constitute what we call ‘the corporation’ and that determine how the entrepreneurial role is carried out in an incorporated firm. It is these relationships that are the subject of corporation law.”). For a recent work criticizing this distinction, see Ann M. Lipton, *Beyond Internal and External: A Taxonomy of Mechanisms for Regulating Corporate Conduct*, 2020 *WIS. L. REV.* 657, 660 (arguing in favor of “a taxonomy of mechanisms that can be used to exert social control over corporate conduct, without regard to whether particular strategies are characterized as ‘external’ or ‘internal’”). For a response to Professor Lipton's argument, see *infra* note 143.

31. Li-Wen Lin, *Corporate Social Responsibility in China: Window Dressing or Structural Change?*, 28 *BERKELEY J. INT'L L.* 64, 64 (2010), *quoted in* Elizabeth Pollman, *Corporate Social Responsibility, ESG, and Compliance*, in *THE CAMBRIDGE HANDBOOK OF COMPLIANCE*, *supra* note 15, at 662, 665. As Professor Pollman explains, there are three different ways in which the term “CSR” is commonly used. See Pollman, *supra*, at 665–66. This Article focuses on one of the three—where corporate law would require corporations to go beyond legal compliance—and does not take issue with the other two meanings. See *infra* Section III.B.

32. See *infra* note 367 and accompanying text.

33. See *infra* Section I.A.

social, and governance (ESG) investing³⁴—this does not make it possible to enforce extra-legal demands through *legal* institutions, including those of corporate law.

The second reason, which is particularly important from the viewpoint of stakeholders themselves, concerns the internal structure of corporate law—namely, the broad discretion corporations have to engage in open-ended behavior,³⁵ and the strong protection afforded to directors under the business judgment rule.³⁶ CSR, as currently understood,³⁷ would essentially *demote* stakeholders to the level of shareholders, who are rarely able to sue fiduciaries for any grievance whatsoever. CSR advocates' primary goal—improving the real-world condition of stakeholders—is better achieved through the legal primacy norm (already a well-functioning part of the law), which strictly disallows illegal activity, placing it *outside* directors' prerogative and the business judgment rule.³⁸ While the law is imperfect, it can be improved.³⁹ Such reform might not be easy to achieve, but by design, it is preferable to relying on corporate law's high-information-cost, low-enforceability regime. Indeed, even scholars who identify the law's failures advocate this method for dealing with such shortcomings.⁴⁰ Working to improve

34. See, e.g., Michal Barzuza, Quinn Curtis & David H. Webber, *Shareholder Value(s): Index Fund ESG Activism and the New Millennial Corporate Governance*, 93 S. CAL. L. REV. 1243 (2020); *infra* note 365 and accompanying text. Although the terms “CSR” and “ESG” are often used interchangeably, they are distinct concepts. See Lund & Pollman, *supra* note 6, at 2566, 2612–15.

35. See Raz, *supra* note 26, at 267–77.

36. See, e.g., Leo E. Strine, Jr., *Delaware's Corporate-Law System: Is Corporate America Buying an Exquisite Jewel or a Diamond in the Rough? A Response to Kahan & Kamar's Price Discrimination in the Market for Corporate Law*, 86 CORNELL L. REV. 1257, 1275 (2001) (“The Delaware Model . . . provides corporate managers with the flexibility to do practically any lawful act, subject to judicial review focused on whether the managers were properly motivated and not irrational.”).

37. See, e.g., Gerlinde Berger-Walliser & Inara Scott, *Redefining Corporate Social Responsibility in an Era of Globalization and Regulatory Hardening*, 55 AM. BUS. L.J. 167 *passim* (2018) (criticizing the expansion of positive law as a means to regulate corporations, and advocating for greater reliance on “CSR”).

38. See, e.g., Edward B. Rock & Michael L. Wachter, *Islands of Conscious Power: Law, Norms, and the Self-Governing Corporation*, 149 U. PA. L. REV. 1619, 1674 (2001) (“[T]he duty to act lawfully [is] an area that traditionally has fallen outside of the business judgment rule. Because of public policy imperatives, obeying the law has traditionally been considered a boundary condition within which firms maximize profits, but not, itself, subject to that calculus.”).

39. See *infra* text accompanying notes 52–60 (discussing the three main types of problems with positive law—non-optimal law, the compliance gap, and the enforcement gap—and explaining that they should be alleviated by operating from within non-corporate law and legal institutions).

40. See, e.g., Jared A. Ellias & Robert J. Stark, *Bankruptcy Hardball*, 108 CALIF. L. REV. 745, 784 (2020) (noting, in the context of relations between creditors and corporations, that in

the law's substance and enforcement, instead of casting it aside, or treating it as indiscernible from other human actions, would best serve stakeholder interests.

In sum, this Article operates in two distinct, but related, scholarly spaces. The first is the corporate purpose, or shareholder–stakeholder debate, where this Article shows that the current, dichotomous understanding is misguided: corporate law follows a third path—legal primacy, which is neither shareholder primacy, nor corporate social responsibility (as currently interpreted)—and *should* follow this path, in terms of best defending the legitimate interests of entities, stakeholders, and shareholders alike. The second scholarly space is the broad range of high-currency topics, from *Caremark*, through the legal limits on dividends and buybacks, to directors' duties in the vicinity of insolvency, which so far have been studied apart from one another. This Article ties them into a single unifying norm, connecting doctrine with foundational theory, and enabling legal participants to better legislate, adjudicate, and study these devices.⁴¹

This Article proceeds as follows: Part I discusses the theoretical foundations on which the legal primacy norm rests. These include the requirement of legal obedience, embedded in the concept of law; the corporation's entity nature; and several aspects of corporate law's internal structure, including the law of corporate purpose, fiduciary duties, and the unique status of shareholders as residual claimants. Part II examines six different doctrines or legal phenomena, through which legal primacy is executed in practice. Part III caps off the discussion by clarifying the distinction between legal primacy and both of the prevailing conceptions in the corporate law community—shareholder primacy and corporate social responsibility—explaining how the ideas offered in this Article can help chart a more nuanced way forward for corporate law, and broader legal scholarship and policymaking.

recent years “[w]ell-established norms and patterns of behavior have been upset and broken, and basic standards of comity have devolved,” and yet the changes suggested by the authors to deal with this problem “are entirely under the control of judges and would not require significant legislation or major shifts in the law”); Jonathan Brogaard & Yesha Yadav, *The Broken Bond Market* (Vanderbilt L. Rsch. Paper No. 21-43, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3941941 [<https://perma.cc/7XSM-MNJW>] (identifying causes of inadequate investor protection in the corporate bond market, and suggesting legal solutions for them).

41. For example, an open question in this area is whether directors' *Caremark* duties should apply only in regard to violations of public law, or should they cover private law obligations as well. See, e.g., Edward B. Rock, *Adapting to the New Shareholder-Centric Reality*, 161 U. PA. L. REV. 1907, 1965–67 (2013). The analysis in this Article indicates there is no fundamental difference between the two: a director who causes, or fails to prevent, the corporation's violation of either public (say, criminal) or private (say, trust) law breaches the same duty toward the corporation.

I. THE FOUNDATIONS: UNDERSTANDING THE INTERFACE BETWEEN THE RULE OF LAW, PERSONHOOD, AND THE STRUCTURE OF CORPORATE LAW

A. *The Conceptual Elements of the Rule of Law*

Legal concepts were famously the subject of derision by early members of the influential legal realist movement.⁴² In reality, however, most activity by legislators, judges, lawyers, and other actors is controlled, to a large extent, by the application of legal concepts and categories. For example, if a certain situation comes within the ambit of the “internal affairs” doctrine,⁴³ the lawsuit pertaining to it will be governed by the law of the state of incorporation (and will typically be filed in the Delaware Court of Chancery).⁴⁴ On the other hand, if the legal dispute lies outside of the corporation’s internal affairs, it will be adjudicated according to regular conflict of laws and jurisdictional rules.⁴⁵

The internal affairs doctrine is a fairly advanced example in the hierarchy of legal concepts. Like other such concepts, it rests on several more fundamental assumptions: first, the existence of legal *norms*, which in turn give rise to legal *rights* and *duties*;⁴⁶ second, the fact that legal norms (as opposed to ethical or aspirational ones) *must* be obeyed;⁴⁷ third,

42. See, e.g., Felix S. Cohen, *Transcendental Nonsense and the Functional Approach*, 35 COLUM. L. REV. 809, 809, 820 (1935) (comparing legal classification to using “a hair-splitting machine” and stating that “[a legal] proposition . . . would be scientifically useful if [the legal concepts it uses] were defined in non-legal terms”). For a recent work discussing and criticizing this aspect of legal realism, see Henry E. Smith, *Equity as Meta-Law*, 130 YALE L.J. 1050, 1142 (2021) (“After Legal Realism . . . seeing law, especially private law, as having a structure goes against the grain. Nevertheless, we have the resources.”).

43. See Vincent S.J. Buccola, *Opportunism and Internal Affairs*, 93 TUL. L. REV. 339, 340 (2018) (“The internal affairs doctrine . . . holds that the chartering state alone should govern a corporation’s ‘internal affairs’—what the Restatement (Second) of Conflict of Laws defines as ‘the relations inter se of the corporation, its shareholders, directors, officers or agents.’ In contrast, the rights and obligations of ‘third persons,’ namely those other than ‘the directors, officers or stockholders of the corporation,’ are subject to ordinary conflicts analysis.” (footnotes omitted) (quoting RESTATEMENT (SECOND) OF CONFLICT OF LAWS §§ 301 cmt. a, 302 cmt. a (AM. L. INST. 1971))).

44. See DEL. CODE ANN. tit. 8, § 115 (2022) (“[N]o provision of the certificate of incorporation or the bylaws may prohibit bringing [internal corporate] claims in the courts of this State.”).

45. See Buccola, *supra* note 43, at 340.

46. See, e.g., Gideon Parchomovsky & Alex Stein, *Empowering Individual Plaintiffs*, 102 CORNELL L. REV. 1319, 1320 (2017) (“Our legal system is organized around the concepts of rights and duties.”); see also *id.* at 1320 n.1 (citing Wesley Newcomb Hohfeld, *Some Fundamental Legal Conceptions as Applied in Judicial Reasoning*, 23 YALE L.J. 16 (1913), and stating that Hohfeld’s article provides “a classic account of this organization”).

47. See, e.g., Griffith, *supra* note 15, at 673 (“Law is what you must do—the rules and regulations originating from the sovereign, transgression of which may lead to deprivation of

the presence of *people* who are subject to legal norms, and bear legal rights or duties;⁴⁸ and fourth, the fact that legal norms, rights, and duties have *content*, and can differ from one another.⁴⁹

For example, shareholders suing a corporation for unduly canceling their shares are invoking legal norms covered by the internal affairs doctrine (or, more generally, by corporate law). Bondholders, suing the same corporation⁵⁰ for not paying on time, are invoking a different set of legal norms, sounding in contract and indenture law. In every case, the real-world behavior required of each actor differs according to the content of their rights or duties: it *might* be that canceling the shares was lawful, and withholding the payment to the bondholders was not (or vice versa), according to what the relevant legal norms say, as determined by legal institutions (in this case, the courts hearing each lawsuit).⁵¹ Rights and duties also have a dimensional extent: the owner of a thousand shares is entitled to more than the owner of one hundred shares, and the owner of bonds having a \$1,000 redemption value is entitled to more than the owner of one-tenth of that amount.

property or, in some cases, liberty. Ethics is what you should do. Ethical norms originate from somewhere other than the sovereign, and, when transgressed, may generate negative publicity and lead to adverse consequences in capital, product, or labor markets.”).

48. See, e.g., Curtis Nyquist, *Teaching Wesley Hohfeld’s Theory of Legal Relations*, 52 J. LEGAL EDUC. 238, 239–40 (2002) (“[Hohfeld] argues that a legal relation is always between two persons [I]f someone has a Hohfeldian right, another person has a duty.”); Alex Stein, *Second-Personal Evidence*, in PHILOSOPHICAL FOUNDATIONS OF EVIDENCE LAW 96, 96 (Christian Dahlman, Alex Stein & Giovanni Tuzet eds., 2021) (“Hohfeld’s scheme of jural opposites and correlatives unfolded analytical proof that every legal entitlement ultimately transforms into a person’s right, or lack thereof”).

49. See, e.g., Raz, *supra* note 19, at 556–57.

50. Like the defendant-corporation, the plaintiff-bondholders might be the exact same people as the shareholders from the previous case. The more important inquiry, however, is about the *content* of the Hohfeldian rights and duties being invoked in a given case or situation. See, e.g., *id.* This fact has many implications in practice. See, e.g., Ga. Notes 18, LLC v. Net Element, Inc., C.A. No. 2021-0246-JRS, 2021 Del. Ch. LEXIS 268, at *8–9 (Del. Ch. Nov. 18, 2021) (“While the [plaintiff’s] claim may well be valid, it is a claim [the plaintiff] will assert as [the defendant’s] creditor, not as [the defendant’s] stockholder. . . . Since [the plaintiff’s] primary purpose for inspection is to advance its interests as creditor, not as stockholder, the [defendant’s] rejection of the Demand was justified.”).

51. Legal institutions extend beyond legislatures, courts, and regulatory agencies. To some degree, every person might be viewed as a legal institution, interpreting and applying legal norms. See, e.g., YUVAL FELDMAN, *THE LAW OF GOOD PEOPLE* (2018). At the same time, there is some hierarchy among legal institutions: absent exceptional circumstances, a court can tell a person how to behave, and to compel this behavior, even if contrary to the person’s understanding of the applicable legal norms.

The analysis here does *not* assume certain things.⁵² First, it does not say that the law is perfect (the problem of *non-optimal law*); to the contrary, law can, and frequently does, change.⁵³ Second, it does not claim that the law is always obeyed in practice (the *compliance gap*); instead, the role of legal institutions is very often to remedy and deter unlawful behavior. Third, it does not assert that these institutions always succeed in doing so (the *enforcement gap*); clearly, the Environmental Protection Agency does not prevent all unlawful pollution, and the flagrant under-enforcement of big tech companies' duties under competition, consumer protection, privacy, and other laws must reverse course (as it is beginning to).⁵⁴ Related to all three of these issues, it is not always clear *what* legal norms actually command; legal actors have some wiggle room, subject to individual judgment, within which they can remain in compliance (or even reshape what "compliance" means).⁵⁵

Still, in any given situation, there *is* a range of behaviors that can be deemed lawful, and others which cannot. These ranges might be narrow (if the redemption value of a bond, according to its indenture and any other applicable legal norm, is precisely \$100, that is what the corporation should pay the bondholder),⁵⁶ or they might be wide (under what circumstances does the "employment at will" doctrine not apply?), but

52. The argument made in these paragraphs is meant to respond, among other things, to a common stakeholderist view: that a corporation never has only one group of residual claimants (shareholders), because many different stakeholders face risk and uncertainty. *See, e.g.,* Lynn A. Stout, *Bad and Not-So-Bad Arguments for Shareholder Primacy*, 75 S. CAL. L. REV. 1189, 1194–95 (2002); Sung Eun ("Summer") Kim, *Tracing the Diverse History of Corporate Residual Claimants*, 95 S. CAL. L. REV. POSTSCRIPT 43 (2021). Indeed, stakeholders encounter risk and uncertainty, but not because their legal claim is fundamentally residual (as is the case for shareholders). Instead, it is the result of the issues described here: non-optimal law, the compliance gap, and the enforcement gap. These problems can be alleviated by operating *from within* the non-corporate legal frameworks that give rise to stakeholders' rights.

53. For example, during the term of the 116th Congress of the United States, from 2019 to 2021, a total of 344 new statutes were enacted into law. *See Public Laws of 116th Congress*, LIBR. CONG., <https://www.congress.gov/public-laws/116th-congress> [<https://perma.cc/B7VN-7RDF>].

54. *See, e.g.,* Rupert Goodwins, *Google's 'Be Evil' Business Transformation Is Complete: Time for the End Game*, REGISTER (Nov. 1, 2021, 9:27 AM), https://www.theregister.com/2021/11/01/google_opinion_column [<https://perma.cc/6RY9-JL7L>] (discussing the severe misconduct alleged in the case of *In re Google Digital Advertising Antitrust Litigation*, C.A. No. 1:21-md-03010-PKC (S.D.N.Y. filed Aug. 12, 2021)).

55. *See, e.g.,* Elizabeth Pollman, *Corporate Disobedience*, 68 DUKE L.J. 709, 731–47 (2019); *see also* Katja Langenbucher, *Regulatory Arbitrage: What's Law Got To Do With It?*, 11 ACCT. ECON. & L. 91, 92 (2021) ("[L]egal rules exist to provide a secure framework for citizens. This implies that actions which do not cross the . . . lines drawn by legal rules are, naturally, not prohibited. At the same time, behavior which complies with the wording, but not with the spirit of a rule will often be perceived as non honestum (dishonest).").

56. For discussion of the various positive law mechanisms that determine the scope of corporate debt, see Zohar Goshen, Richard Squire & Felix Steffek, *The Law of Corporate Debt: A Unifying Theory* (Nov. 24, 2021) (unpublished manuscript) (on file with author).

they exist.⁵⁷ When someone acts unlawfully, that is a *violation* of law, and it is logically false to use that as an argument against the law itself.⁵⁸ Instead, what legal participants should be doing—and often *are* doing⁵⁹—is finding the most effective routes to alleviate the problems of non-optimal law, the compliance gap, and the enforcement gap. This requires operating from within the law and legal institutions, rather than casting them aside, or believing that the law can mean “anything anyone might wish for.”⁶⁰

If we are living in a society where respect for other people’s life choices is possible, there is no other option: the law is *supreme*—it is what we must obey⁶¹—but it is not *all-encompassing*. At some point, law ends, and non-legal choice begins. To give one clear example, “the concept of ‘family’ is not the same as ‘family law’: the latter limits what spouses and parents can do, but beyond that lies a wide range where law simply says nothing—neither positive nor negative—about how to be a good spouse or parent.”⁶² To a large degree, law itself facilitates individual self-determination, as exemplified by the distinction between private and public law.⁶³

This short introduction to fundamental legal concepts is necessary for the discussion in the remainder of this Article, and informs the discourse on legal compliance and the role of corporations in society. To engage in that discourse more fully, the concepts introduced above need to be coupled with several additional building blocks, coming from within a specific legal area: corporate law. As Sections I.B and I.C demonstrate, corporate law achieves some fairly exceptional feats with regard to the concepts of personhood, purpose, and compliance.

57. See, e.g., Raz, *supra* note 19, at 550 (“It is not always easy to ascertain what positive law says, but it does say *something*, and does not say *anything* anyone might wish for.”).

58. For an argument of this kind, see Leo E. Strine, Jr., *Who Bleeds When the Wolves Bite?: A Flesh-and-Blood Perspective on Hedge Fund Activism and Our Strange Corporate Governance System*, 126 YALE L.J. 1870, 1928–29 (2017) (arguing that the legal concept of “residual claimants” is largely illusory, because “[c]ertain stockholders can come in and reap trading profits, even if the underlying corporation’s ability to create value is compromised to the detriment of continuing stockholders, company workers, and creditors”).

59. See, e.g., *supra* note 53.

60. Raz, *supra* note 19, at 550 (emphasis omitted).

61. See, e.g., Griffith, *supra* note 15, at 673.

62. Asaf Raz, *Why Corporate Law Is Private Law* 12 (Dec. 22, 2021) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3991950 [<https://perma.cc/L643-QCT2>].

63. See Hanoch Dagan, *Autonomy and Pluralism in Private Law*, in THE OXFORD HANDBOOK OF THE NEW PRIVATE LAW 177, 177 (Andrew S. Gold, John C.P. Goldberg, Daniel B. Kelly, Emily Sherwin & Henry E. Smith eds., 2021) (“[P]rivate law is guided by an autonomy-enhancing *telos*. Private law, at its core, facilitates people’s self-determination and forms the foundation of a social life premised on the maxim of reciprocal respect for self-determination.”); Raz, *supra* note 62, at 13–14.

B. *The Corporation as a Purposeful Entity*

A defining characteristic of corporate law is the fact that every corporation is a separate legal person.⁶⁴ In the United States, over the last decade, public and scholarly discussion about corporate personhood⁶⁵ has tended to focus on two Supreme Court cases, *Citizens United v. FEC*⁶⁶ and *Burwell v. Hobby Lobby Stores, Inc.*⁶⁷ This focus, however, is incomplete and misleading, for two reasons. First, somewhat ironically, these cases have mostly *ignored* corporate personhood, instead relying on an older⁶⁸ and largely discarded theory—the aggregate model, according to which a corporation is merely the sum of other individuals.⁶⁹

Second, and more importantly, the subject of corporations' constitutional rights is only one, specific, and relatively recent aspect of corporate personhood. As a matter of corporate law's internal structure, corporate personhood has been recognized for many centuries.⁷⁰ It has also appeared in numerous Supreme Court and state court cases, some having little to do with constitutional law, and predating the *Santa Clara*⁷¹ case (understood as the beginning of the Supreme Court's expansion of corporate constitutional rights)⁷² by years to decades.⁷³

64. See, e.g., sources cited *supra* note 14; Raz, *supra* note 19, at 539–48.

65. See, e.g., Elizabeth Pollman, *Wrong Turns with Corporate Rights*, 98 B.U. L. REV. ONLINE 44, 44 n.1 (2018) (citing a wide range of recent works in this area).

66. 558 U.S. 310 (2010).

67. 573 U.S. 682 (2014).

68. See, e.g., Jennifer Hill, *Visions and Revisions of the Shareholder*, 48 AM. J. COMPAR. L. 39, 42 (2000) (“The aggregate or partnership model of the corporation, which was prevalent in the 19th century, assumed [a role as the ‘owners’ of the corporate enterprise] for shareholders” (footnote omitted)).

69. See, e.g., ADAM WINKLER, *WE THE CORPORATIONS* 364 (2018) (“Corporate personhood . . . is entirely missing from the [*Citizens United*] opinion. . . . [T]he *Citizens United* decision obscured the corporate entity and emphasized the rights of others, like shareholders and listeners.”); Raz, *supra* note 19, at 571 (explaining how the Supreme Court ignored corporate personhood in *Citizens United* and *Hobby Lobby*).

70. See, e.g., RON HARRIS, *INDUSTRIALIZING ENGLISH LAW: ENTREPRENEURSHIP AND BUSINESS ORGANIZATION, 1720-1844*, at 17–18 & *passim* (2000) (stating that “by the sixteenth century, . . . [i]ncorporation involved the creation of a new personality, distinct from that of individual human beings,” and discussing the consequences of corporate personality in later English law).

71. *Santa Clara County v. S. Pac. R.R. Co.*, 118 U.S. 394 (1886).

72. See Evelyn Atkinson, *Frankenstein’s Baby: The Forgotten History of Corporations, Race, and Equal Protection*, 108 VA. L. REV. 581, 585–86 (2022); Margaret M. Blair & Elizabeth Pollman, *The Derivative Nature of Corporate Constitutional Rights*, 56 WM. & MARY L. REV. 1673, 1689–94 (2015).

73. See, e.g., *Hawes v. Oakland*, 104 U.S. 450, 453–54 (1882) (“This corporation, like others, is created a body politic and corporate [It] may make contracts, commit torts, and incur liabilities, and may sue or be sued in [its] corporate name in regard to all of these transactions. The parties who deal with [the corporation] understand this, and that they are dealing

In modern case law and scholarship, corporate personhood has become even more significant. Multiple Delaware authorities, including landmark cases such as *Unocal*,⁷⁴ *Revlon*,⁷⁵ *Paramount v. Time*,⁷⁶ *Tooley*,⁷⁷ and *Americas Mining*,⁷⁸ insist on the corporation's entity nature.⁷⁹ In academic writing—despite the seeming victory, in the 1980s, of the imprecise and metaphorical “nexus of contracts” language⁸⁰—the

with a body which has these rights and is subject to these obligations, and they do not deal with or count upon a liability to the stockholder whom they do not know and with whom they have no privity of contract or other relation.”), *abrogated on other grounds by* *Kamen v. Kemper Fin. Servs., Inc.*, 500 U.S. 90 (1991); *Smith v. Hurd*, 53 Mass. (12 Met.) 371, 384 (1847) (“The bank is a corporation and body politic, having a separate existence as a distinct person in law The very purpose of incorporation is, to create such legal and ideal person in law, distinct from all the persons composing it, in order to avoid the extreme difficulty, and perhaps . . . the utter impracticability, of such a number of persons acting together in their individual capacities.”).

74. *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 954 (Del. 1985) (“[T]he board’s power to act derives from its fundamental duty and obligation to protect the corporate enterprise . . .”).

75. *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986) (explaining that before the company was for sale, “[t]he duty of the board . . . [was] the preservation of Revlon as a corporate entity” and to serve as “defenders of the corporate bastion”).

76. *Paramount Commc’ns, Inc. v. Time Inc.*, 571 A.2d 1140, 1150 (Del. 1989) (“Delaware law imposes on a board of directors the duty to manage the business and affairs of the corporation. This broad mandate includes a conferred authority to set a corporate course of action . . . designed to enhance corporate profitability. . . . [D]irectors, generally, are obliged to charter a course for a corporation which is in its best interest” (citation omitted)); *Paramount Commc’ns Inc. v. Time Inc.*, C.A. Nos. 10866, 10670, 10935 (Consol.), 1989 Del. Ch. LEXIS 77, at *83–86 (Del. Ch. July 14, 1989) (“[T]he authorities relied upon do not establish that Time, as a corporate entity, has no distinct legally cognizable interest that the Paramount offer endangers. . . . [W]here the board . . . continues to manage the corporation for long-term profit . . . , the corporation has a legally cognizable interest in achieving that plan.”), *aff’d*, 571 A.2d 1140 (Del. 1989).

77. *Tooley v. Donaldson, Lufkin, & Jenrette, Inc.*, 845 A.2d 1031, 1039 (Del. 2004) (“In this case it cannot be concluded that the complaint alleges a derivative claim. There is no derivative claim asserting injury to the corporate entity. There is no relief that would go [to] the corporation.”).

78. *Ams. Mining Corp. v. Theriault*, 51 A.3d 1213, 1264–65 (Del. 2012) (“Because a derivative suit is being brought on behalf of the corporation, any recovery must go to the corporation. . . . [A stockholder’s] individual injury is distinct from an injury to the corporation alone. . . . [T]he corporation was harmed and the total recovery is awarded to the corporation . . . —not ‘nominally’ but actually. . . . No stockholder, including the majority stockholder, has a claim to any particular assets of the corporation.”).

79. The same applies to scholarship written by leading Delaware jurists. *See, e.g.*, Jonathan Macey & Leo E. Strine, Jr., *Citizens United as Bad Corporate Law*, 2019 WIS. L. REV. 451.

80. *See, e.g.*, William W. Bratton, Jr., *The “Nexus of Contracts” Corporation: A Critical Appraisal*, 74 CORNELL L. REV. 407 (1989); David Gibbs-Kneller, David Gindis & Derek Whayman, *Not by Contract Alone: The Contractarian Theory of the Corporation and the Paradox of Implied Terms*, 23 EUR. BUS. ORG. L. REV. 573 (2022); *infra* Section III.A.

separate legal personality of the corporation (or “entity,” or “firm”) is subject to extensive treatment, as well.⁸¹

What can the corporate person do? The short (and surprising) answer is “everything.” The more complete answer, which this Article discusses in detail, is “everything lawful.” While other areas of private law—most notably, contract law—insist on delineating involved actors’ rights and duties before the fact (*ex ante*),⁸² corporate law does something very different: it is organized around a unique principle of open-endedness.⁸³ This principle entails that the corporation can engage in *any* lawful act, promising nothing *ex ante* to its shareholders: neither that it will succeed in its endeavors, nor what those endeavors will actually be, nor what profit it will make, nor how much time any of this will require.⁸⁴ The corporation—including a for-profit corporation—is not even limited to *economic* activity: as recent scholarship illustrates, corporations are immersed in an ever-changing range of enterprises, spanning across political, religious, expressive, and other domains.⁸⁵

The open-endedness principle manifests through several core aspects of corporate law, among them, first, the statutory declaration that a corporation may “engage in any lawful act or activity”;⁸⁶ second, the corporation’s unique trait of perpetual existence,⁸⁷ which expands the range of possible outcomes even beyond that of a natural person; third and most prominently, the business judgment rule. This rule, which is a

81. See, e.g., KRAAKMAN ET AL., *supra* note 14; Ofer Eldar & Andrew Verstein, *The Enduring Distinction Between Business Entities and Security Interests*, 92 S. CAL. L. REV. 213 (2019); Henry Hansmann & Reinier Kraakman, *The Essential Role of Organizational Law*, 110 YALE L.J. 387 (2000); Pargendler, *supra* note 14; Elizabeth Pollman, *Startup Governance*, 168 U. PA. L. REV. 155, 218 (2019) (“The value of the corporation itself . . . best reflects the sum of the participants’ interests and it is to the corporation that the fiduciary duty should be owed.”).

82. See, e.g., Saul Levmore, *The Ex-Middle Problem for Law-and-Economics*, 22 AM. L. & ECON. REV. 1, 2–6 (2020) (“Law-and-economics is driven by an *ex ante* perspective. . . . [T]he very idea of an ex-middle ‘problem’ for law-and-economics is jarring to scholars of contract law.”); Raz, *supra* note 26, at 268–69.

83. See Raz, *supra* note 26, at 267–77.

84. See *id.* at 269–72.

85. See Pargendler, *supra* note 14; Elizabeth Pollman, *Corporate Governance Beyond Economics*, in *THE CORPORATE CONTRACT IN CHANGING TIMES: IS THE LAW KEEPING UP?* 183 (Steven Davidoff Solomon & Randall Stuart Thomas eds., 2019); see also William J. Moon, *Anonymous Companies*, 71 DUKE L.J. 1425 (2022) (discussing an additional aspect of corporate law and personhood that extends beyond economics—namely, privacy).

86. DEL. CODE ANN. tit. 8, § 102(a)(3) (2022).

87. See, e.g., *id.* § 102(b)(5) (stating that, unless the certificate of incorporation specifies otherwise, “the corporation shall have perpetual existence”); Andrew A. Schwartz, *The Perpetual Corporation*, 80 GEO. WASH. L. REV. 764 (2012) (discussing the implications of the modern corporation’s perpetual legal lifespan).

distinctive creature of corporate law,⁸⁸ permits the corporation's managers "to do practically any lawful act, subject to judicial review focused on whether the managers were properly motivated and not irrational."⁸⁹ The business judgment rule has become a linchpin of U.S. corporate law—perhaps over-enthusiastically so⁹⁰—but, when properly understood, the rule serves a crucial function in supporting corporate law's broader structure, particularly its open-endedness principle.⁹¹

As a result, just like the concept of "family" mentioned above,⁹² the idea of a corporation extends well beyond corporate law: we also talk about corporations in economics, management, finance, accounting, psychology, and other disciplines of scholarship and human activity.⁹³ In many situations, these are more important than the corporation's legal aspects. This relates to the fact that corporate law is part of private law,⁹⁴ with its "autonomy-enhancing telos."⁹⁵ The corporation's existence is *enabled* by law,⁹⁶ but—like flesh-and-blood humans—it is not *only* a legal matter. It is also a matter of business judgment and open-ended activities. While those activities are limited *by* law, they are not limited *to* what the law says or contemplates.⁹⁷ For example, "[w]hen SpaceX—a Delaware corporation—produces a heavy-lift space launch system, this has nothing to do with its [public law] liabilities . . . ; it had to meet those in the process, but the 'residual' act of creating the rocket . . . is made possible by the autonomy-enhancing role of private law."⁹⁸

The open-ended nature of corporate activity also challenges a well-known scholarly argument: that corporate law, as a whole, should be made more certain, in terms of less litigation, broader safe harbors, or

88. See, e.g., Julian Velasco, *Fiduciary Judgment Rules*, 62 WM. & MARY L. REV. 1397, 1414–15 (2021) ("Perhaps the most obvious way in which corporate law differs from other applications of fiduciary law is in the business judgment rule. . . . [T]he business judgment rule actually serves the purposes of fiduciary law in corporate law's special circumstances.").

89. Strine, *supra* note 36, at 1275.

90. See Lyman Johnson, *Unsettledness in Delaware Corporate Law: Business Judgment Rule, Corporate Purpose*, 38 DEL. J. CORP. L. 405, 423–31 (2013).

91. See Raz, *supra* note 26, at 240 n.92.

92. See *supra* note 62 and accompanying text.

93. See, e.g., *supra* note 34 and accompanying text.

94. See Raz, *supra* note 62.

95. Dagan, *supra* note 63, at 177 (emphasis omitted).

96. See, e.g., Paul B. Miller, *Corporate Personality, Purpose, and Liability*, in RESEARCH HANDBOOK ON CORPORATE PURPOSE AND PERSONHOOD, *supra* note 14, at 222, 223 ("[T]he law constitutes corporate persons and enables genuinely corporate purposive action . . .").

97. See, e.g., Strine, *supra* note 36, at 1275 ("The Delaware Model . . . provides corporate managers with the flexibility to do practically any lawful act . . ."); Raz, *supra* note 62, at 13–14.

98. Raz, *supra* note 62, at 15–16 (footnote omitted).

more predefined barriers against fiduciary liability.⁹⁹ This branch of scholarship starts from the assumption that *ex ante* uncertainty, and *ex post*, equity-based judicial supervision are mostly a bad thing.¹⁰⁰

Yet, corporate law is *precisely about* keeping the future unknown, through such discretion-granting doctrines as the business judgment rule. Calls for greater certainty before the fact thus turn corporate law on its head: the reason we have the business judgment rule, in the first place, is to promote uncertainty, risk taking, and open-ended endeavors, which often generate immense economic and social benefits. At the same time, directors and other fiduciaries do not *always* employ their broad powers in the good faith exercise of business judgment. Litigation is often necessary to find out whether they have done so in a specific situation. Bright-line *ex ante* rules cannot foreclose such litigation—no more than the corporation’s business activities, or its directors’ decisions (the subject of those same lawsuits), are limited by such rules.¹⁰¹ Importantly, even where Delaware corporate law has moved toward more *ex ante* certainty, it has done so within the overarching framework of equity and *ex post* judicial review, designed to respond to the exceptionally wide, unpredictable range of eventualities that corporate law not merely enables, but encourages.¹⁰²

Crucially, however, the structure of corporate law does not end here. Even the open-ended trajectory of corporate life is subject to some *ex ante* constraints. Put simply, there are behaviors that lie *outside* of the permissive business judgment rule and the other *ex post* devices discussed above. The majority of this Article is devoted to one such limit: the legal primacy norm, which demands strict compliance with non-corporate law, placing that requirement above the pursuit of profit, and

99. See, e.g., Marcel Kahan & Ehud Kamar, *Price Discrimination in the Market for Corporate Law*, 86 CORNELL L. REV. 1205 (2001) (criticizing the lack of *ex ante* certainty in corporate law; also suggesting that the prevalence of corporate litigation is a matter of political economy, through which Delaware preserves its status as the premier venue for incorporation).

100. Cf. Levmore, *supra* note 82, at 2 (“Law-and-economics is driven by an *ex ante* perspective.”).

101. See Raz, *supra* note 26, at 240 n.92, 272–74.

102. See, e.g., *In re Dell Techs. Inc. Class V S’holders Litig.*, Consol. C.A. No. 2018-0816-JTL, 2020 Del. Ch. LEXIS 211, at *96 (Del. Ch. June 11, 2020) (noting, while deciding whether to apply the safe harbor established in *Kahn v. M&F Worldwide Corp.*, 88 A.3d 635 (Del. 2014), that “[a] court must still determine whether the defendant fiduciaries acted equitably. . . . The fact that the Conversion Right appears in the certificate of incorporation does not obviate the need for equitable analysis”); *Boilermakers Loc. 154 Ret. Fund v. Chevron Corp.*, 73 A.3d 934, 949–63 (Del. Ch. 2013) (“[F]orum selection clauses . . . [should be] den[ied] enforcement . . . to the limited extent necessary to avoid some fundamentally inequitable result [T]he main point remains . . . [that the law] provides protection in the event that a plaintiff believes that the clause is operating in a situationally unreasonable or unlawful manner. . . . [T]he board’s use of its powers under the bylaw is subject to challenge as inconsistent with its fiduciary duties in the event of an actual dispute.”).

enforcing it through intra-corporate doctrines. Yet, corporate law imposes an additional constraint, which cannot be neglected: the broader law of corporate purpose.¹⁰³ When a for-profit corporation goes about its business, it has to do so in a manner that seeks to lawfully generate profit.¹⁰⁴ Equally, a benefit or nonprofit corporation has to lawfully pursue its purpose.¹⁰⁵ In fact, despite the confidence with which the Business Roundtable members (several corporate directors and officers) “declared” a new purpose for their corporations in 2019,¹⁰⁶ they never had any legally binding power to do so; corporate purpose is a legal requirement, dictated by state corporate law.¹⁰⁷

There is also a concrete group of people whose interests are directly affected by the “profit” part of the corporation’s purpose: shareholders.

103. See, e.g., David G. Yosifon, *The Law of Corporate Purpose*, 10 BERKELEY BUS. L.J. 181 (2013).

104. The pursuit of profit—or any other corporate purpose—must always mean the *lawful* pursuit of that purpose. Both the “lawful” and the “profit” are embedded in the corporation’s purpose. See Raz, *supra* note 19, at 533–39. In traditional corporate law scholarship, the latter received much greater attention, which this Article aims to correct. There is no contradiction between the two parts, as one (profit) is always subordinated to the other (lawfulness). Both levels of this hierarchy should be respected by lawmakers and scholars. For recent, well-nuanced works that make this argument, see ALEX EDMANS, *GROW THE PIE: HOW GREAT COMPANIES DELIVER BOTH PURPOSE AND PROFIT* (2020); Christina Parajon Skinner, *Cancelling Capitalism?*, 97 NOTRE DAME L. REV. 417 (2021) (book review).

105. See, e.g., DEL. CODE ANN. tit. 8, § 362(a)–(b) (2022) (providing detailed rules regarding the purpose of benefit corporations).

106. See *Business Roundtable Redefines the Purpose of a Corporation to Promote ‘An Economy That Serves All Americans’*, BUS. ROUNDTABLE (Aug. 19, 2019), <https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans> [<https://perma.cc/J49C-Q6FH>].

107. See, e.g., *Paramount Commc’ns, Inc. v. Time Inc.*, 571 A.2d 1140, 1150 (Del. 1989) (“[Directors’] broad mandate includes a conferred authority to set a corporate course of action . . . designed to enhance corporate profitability.”); *In re Trados Inc. S’holder Litig.*, 73 A.3d 17, 36–37 (Del. Ch. 2013) (“[Directors’ decisions should] benefit the corporation as a whole . . . by increasing the value of the corporation . . . [T]he duty of loyalty therefore mandates that directors maximize the value of the corporation over the long-term . . .”); *eBay Domestic Holdings, Inc. v. Newmark*, 16 A.3d 1, 34 (Del. Ch. 2010) (“I cannot accept as valid . . . a corporate policy that . . . seeks *not* to maximize the economic value of a for-profit Delaware corporation . . .”); Yosifon, *supra* note 103. For a similar statement, although employing one mistaken phrase, see Robert J. Rhee, *A Legal Theory of Shareholder Primacy*, 102 MINN. L. REV. 1951, 2016–17 (2018) (“Shareholder primacy is law, and not just a social norm. . . . [T]he normative debate and policy prescription must be informed by a positive theory of law. . . . The cause and effect of shareholder primacy rests on a legal foundation, and not some general notion of collective social belief that perhaps can change with enough suasion or argument. Any policy prescription from a normative theory must contend with the fact that there is a law of shareholder primacy.”). If we change the words “shareholder primacy” to “corporate purpose”—which, as this Article explains, is the *lawful* pursuit of profit, by a corporate *entity* whose shareholders have substantial, yet subordinated rights—Professor Rhee’s statement becomes entirely accurate (and important, especially in the wake of the Business Roundtable’s extra-legal attempt to modify corporate purpose).

The global value of publicly traded shares, in 2019, was over \$60 trillion.¹⁰⁸ The process that generates this value, albeit often misunderstood,¹⁰⁹ is a specific *legal* mechanism: share law, which is part of corporate law.¹¹⁰ The law of shares is grounded in concepts of equity.¹¹¹ Shareholders are not “owners” of the corporate entity, nor do they own its assets.¹¹² Shareholders are strongly veiled from the corporation’s property and affairs, through the concepts of asset partitioning,¹¹³ capital lock-in,¹¹⁴ and director-centric governance.¹¹⁵ Dividends, buybacks, and merger proceeds only occasionally get distributed, subject to the corporation’s decision, through its directors.¹¹⁶

Although shareholders enjoy no “primacy,” they have *some* substantial legal rights. Among other things, shareholders are endowed with an enforceable right to have the corporation pursue its purpose.¹¹⁷ The gist of directors’ and officers’ fiduciary duty is the advancement of the corporation’s purpose.¹¹⁸ When they fail to do so (by acting in their

108. See *Stocks Traded, Total Value (Current US\$)*, WORLD BANK, <https://data.worldbank.org/indicator/CM.MKT.TRAD.CD> [<https://perma.cc/ZAV2-K4R3>] (indicating that the total value of shares publicly traded worldwide, in 2019, was \$61.139 trillion).

109. See, e.g., Paddy Ireland, *Company Law and the Myth of Shareholder Ownership*, 62 MOD. L. REV. 32, 33 (1999) (“[T]he legal nature of the share and shareholding are surrounded by uncertainty. As L.C.B. Gower says, the share does not readily fit into any ‘normal legal category.’” (quoting PAUL L. DAVIES, *GOWER’S PRINCIPLES OF MODERN COMPANY LAW* 321 (6th ed. 1997))).

110. See Asaf Raz, Comment, *Share Law: Toward a New Understanding of Corporate Law*, 40 U. PA. J. INT’L L. 255 (2018).

111. See *id.* at 302–11; Paul B. Miller, *Equity, Majoritarian Governance, and the Oppression Remedy*, in FIDUCIARY OBLIGATIONS IN BUSINESS 171 (Arthur B. Laby & Jacob Hale Russell eds., 2021).

112. See Raz, *supra* note 110, at 285–87.

113. See, e.g., Hansmann & Kraakman, *supra* note 81, at 390.

114. See, e.g., Elisabeth de Fontenay, *Individual Autonomy in Corporate Law*, 8 HARV. BUS. L. REV. 183, 201 (2018) (“Recognizing the corporation as the owner of [its] assets . . . is . . . the key to its success in fostering economic growth precisely because it prevents individual shareholders from removing productive business assets at will.”).

115. See, e.g., DEL. CODE ANN. tit. 8, § 141(a) (2022) (“The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors . . .”).

116. See, e.g., *id.* §§ 170(a) (“The directors of every corporation . . . may declare and pay dividends upon the shares of its capital stock . . .”), 251(b) (“The board of directors of each corporation which desires to merge . . . shall adopt a resolution approving an agreement of merger . . .”); *infra* Section II.C.

117. See Raz, *supra* note 19, at 562; Raz, *supra* note 110, at 291 n.142, 318–19; *supra* note 107 (citing several cases where the law of corporate purpose has been enforced or invoked in Delaware corporate litigation).

118. See *infra* Section II.A. In exceptional cases, especially in the mergers and acquisitions context, fiduciary duties might run directly to shareholders, rather than to the corporate entity. See, e.g., *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986).

self-interest, in some third party's interest, or with lack of good faith),¹¹⁹ corporate law will intervene.¹²⁰ Many high-profile debates in corporate law reside in this area—for example, those over dual-class share structures,¹²¹ staggered boards,¹²² and the use of the poison pill as a defensive tactic against takeovers and activist shareholders.¹²³ These topics have long been at the center of corporate law scholarship (certainly prior to the re-emergence of the corporate purpose debate in 2019), and most of the “agency costs” literature operates in this quarter.

We now reach the core of this Article's argument: while corporate law grants substantial rights to shareholders, in the first place, they are defined as *residual* claimants,¹²⁴ meaning that their legal and economic claims rank *below* those of any other person dealing with the corporation.¹²⁵ Just as important as the shareholder-centric questions, with which corporate law scholarship has traditionally grappled, is how we *delineate* those rights—in other words, what sets an upper *limit* on shareholders' claims, and on the pursuit of profit generally. As the remainder of this Article shows, that limit—the legal primacy norm—lies at the heart of corporate law, no less, and in some respects more, than shareholders' rights or the corporation's pursuit of profit.

C. How Corporate Law Makes the Corporation Subject to Broader Private and Public Law

The legal primacy norm is an inevitable product of the conceptual building blocks introduced above. On a preliminary level, because

Even in those situations, the legal primacy norm, as discussed in this Article, is fully binding. *See infra* note 335.

119. *See infra* Section II.A.

120. *See, e.g.*, sources cited *supra* note 107.

121. *Compare, e.g.*, Lucian A. Bebchuk & Kobi Kastiel, *The Untenable Case for Perpetual Dual-Class Stock*, 103 VA. L. REV. 585, 590–91 (2017) (advocating the adoption of “sunsets,” which mandate the cancellation of the more senior class of shares a certain period of time after its issuance), *with, e.g.*, Jill Fisch & Steven Davidoff Solomon, *The Problem of Sunsets*, 99 B.U. L. REV. 1057, 1063–64 (2019) (criticizing this possibility).

122. *See, e.g.*, Yakov Amihud, Markus Schmid & Steven Davidoff Solomon, *Settling the Staggered Board Debate*, 166 U. PA. L. REV. 1475 (2018).

123. *See, e.g.*, *In re Williams Cos. S'holder Litig.*, Consol. C.A. No. 2020-0707-KSJM, 2021 Del. Ch. LEXIS 34 (Del. Ch. Feb. 26, 2021) (enjoining directors' attempt to use an overly broad anti-activist poison pill); Lucian A. Bebchuk & Robert J. Jackson, Jr., *Toward a Constitutional Review of the Poison Pill*, 114 COLUM. L. REV. 1549 (2014).

124. *See, e.g.*, Raz, *supra* note 110, at 272–76.

125. This fact is illustrated throughout this Article, but it is worth noting that even the most contractarian law and economics scholars have recognized it (although not its central place in corporate law and practice). *See, e.g.*, FRANK H. EASTERBROOK & DANIEL R. FISCHEL, *THE ECONOMIC STRUCTURE OF CORPORATE LAW* 11 (1991) (“Equity investors are paid last, after debt investors, employees, and other investors These equity investors have the ‘residual’ claim in the sense that they get only what is left over”).

corporate law dictates that the corporation is a legal person,¹²⁶ and because every person must obey the law,¹²⁷ corporations are equally subject to the law as any individual. The requirement of lawful behavior is not merely “a function of the basic fact that it is only through government-granted charters that corporations exist”¹²⁸—a concession theory that has lost valence in modern reality.¹²⁹ Quite the opposite: precisely because the corporation is a creature of *private law*, a free-acting person that can engage in open-ended activities,¹³⁰ *all* laws apply to it, just as they do to human beings.¹³¹

In other words, the fact that law exists does not mean that people do not have their own spheres of autonomy, and vice versa.¹³² It is equally impossible to make an unlawful contract,¹³³ to violate the law even on one’s private property,¹³⁴ or to create a rogue, outlaw corporate person.¹³⁵ The law does not say that there is to be no profit, but there is to be no

126. See *supra* notes 14, 64, 81 and accompanying text.

127. See, e.g., Griffith, *supra* note 15, at 673.

128. Pollman, *supra* note 55, at 719.

129. See, e.g., John C. Coates IV, Note, *State Takeover Statutes and Corporate Theory: The Revival of an Old Debate*, 64 N.Y.U. L. REV. 806, 831 (1989) (“[From the turn of the twentieth century,] theorists [could no longer] realistically point to state corporate laws or charters granted under these laws as representing any real decision of a state either to permit the corporation to exist or to shape the nature of that existence.” (footnote omitted)); Raz, *supra* note 62, at 16–26.

130. See *supra* text accompanying notes 82–102.

131. This statement refers to all laws that *can* be applied to corporations. While the corporation is a legal person with human-like traits, it is not a human, and a few acts are beyond its capacity, such as getting married, voting in the general election, and others. See, e.g., *In re Dole Food Co., Inc. S’holder Litig.*, 110 A.3d 1257, 1263–64 (Del. Ch. 2015) (precluding a corporation from serving as an expert witness); Miller, *supra* note 96, at 225 (“[Artificial persons’] capacities [may be] expressly delimited at law, or . . . there [may be] no rational basis in fact for the ascription of particular capacities to an artificial person.”); Raz, *supra* note 19, at 540 & n.87. In any event, these are exceptions to the rule of broad corporate capacity.

132. See *supra* text accompanying note 62.

133. See, e.g., RESTATEMENT (SECOND) OF CONTS. § 179 (AM. L. INST. 1981) (“A public policy against the enforcement of promises or other terms may be derived by the court from . . . legislation relevant to such a policy[.]”); Steven W. Feldman, *Statutes and Rules of Law as Implied Contract Terms: The Divergent Approaches and a Proposed Solution*, 19 U. PA. J. BUS. L. 809, 810, 850–51 (2017) (stating that “[t]he great majority of state and federal courts accept the general common law rule that courts in construing contracts shall incorporate relevant, unmentioned laws as implied contract terms,” and discussing sources that support an “immutable rule” in this regard).

134. See, e.g., Lisa M. Austin, *Property and the Rule of Law*, 20 LEGAL THEORY 79, 82–83 (2014) (“The fact that the common law of private property expresses rule-of-law values in one way does not preclude legislation from expressing them in another way. The ‘freedom’ question within this rule-of-law framework is whether the state regulation itself expresses rule-of-law values and not whether it derogates from the common-law idea of private ownership.”).

135. See, e.g., *Desimone v. Barrows*, 924 A.2d 908, 934 (Del. Ch. 2007) (“Although directors have wide authority to take lawful action on behalf of the corporation, they have no authority knowingly to cause the corporation to become a rogue . . .”).

profit except such as is lawful.¹³⁶ This point has partly evaded corporate law scholars, as evidenced by the polar shareholder–stakeholder dichotomy.¹³⁷ In fact, law and private choice are not dichotomous, but complementary.¹³⁸

Relatedly, given the wide variety of laws (both private and public) that exist in our society, the main source of legal duties imposed on corporations is *non-corporate* law. Recent high-profile cases demonstrate this: the opioid litigation,¹³⁹ the Google antitrust lawsuit,¹⁴⁰ and the Citibank restitution case¹⁴¹ are not corporate law cases, even though the defendants are corporations. They do not concern the corporation’s “internal affairs,”¹⁴² or the rights and duties of the entity, its shareholders, and its fiduciaries vis-à-vis one another. Instead, these cases are grounded in what Professor Ronald Coase and subsequent scholars would view as external areas of law,¹⁴³ or as Professor Larry Ribstein called it, “non-organization law.”¹⁴⁴ The various norms of non-corporate law are a

136. Cf. *Hutton v. W. Cork Ry. Co.* (1883) 23 Ch. D. 654, 673 (Eng.) (“The law does not say that there are to be no cakes and ale, but there are to be no cakes and ale except such as are required for the benefit of the company.”).

137. See *supra* note 7 and accompanying text; *infra* Part III.

138. See *supra* note 104.

139. See *supra* note 17.

140. See *supra* note 54.

141. *Citibank, N.A. v. Brigade Cap. Mgmt., LP*, 49 F.4th 42 (2d Cir. 2022) (case involving the mistaken wire transfer, by a bank, of approximately \$900 million, in a unique factual setting where some of the transferees—several private investment fund managing entities—have argued that they have a legal right to keep the funds). For useful discussions of the case (written prior to the final appellate decision), see Elisabeth de Fontenay, *The \$900 Million Mistake: In re Citibank August 11, 2020 Wire Transfers* (SDNY 16 February 2021), 16 CAP. MKTS. L.J. 307 (2021); Maytal Gilboa & Yotam Kaplan, *The Costs of Mistakes*, 122 COLUM. L. REV. F. 61 (2022); Eric Talley, *Discharging the Discharge-for-Value Defense*, 18 N.Y.U. J.L. & BUS. 147 (2021).

142. See Buccola, *supra* note 43, at 340.

143. See *supra* note 30. The argument made in this Article also responds to Professor Lipton’s criticism of the internal–external distinction, see Lipton, *supra* note 30. Professor Lipton is correct that external, non-corporate laws, such as employment or environmental law, strongly affect the daily activities of corporations. See *id.* at 658–59. Yet, this does not collapse the internal–external boundary; it does not mean that employment and environmental law are part of corporate law. In other words, it does not negate the distinction between different Hohfeldian rights, even if they are all asserted against the same person. See *supra* note 50. Instead, there is a specific process—the legal primacy norm—that takes non-corporate laws as “inputs,” and produces fiduciary liability, or limits on shareholders’ claims, as “outputs.” That process operates within corporate law, in a manner consistent with its other building blocks. This Article illustrates how such distinctions matter in practice: for example, stakeholders have no privity with the corporation’s directors, whose duties run solely to the entity. As a result, most lawsuits for causing the corporation to act unlawfully can only proceed as derivative, not direct, claims—a highly material difference under Delaware law. See *infra* Section II.D.

144. Larry E. Ribstein, *The Important Role of Non-Organization Law*, 40 WAKE FOREST L. REV. 751 (2005). For a similar idea, see Tamar Frankel, *The Delaware Business Trust Act Failure*

prerequisite, or frame of reference, for corporate law's internal legal primacy norm.

Theoretically, corporate law could have stopped here: saying "every corporation is a legal person" (a far-reaching statement by itself), and leaving external law to demand compliance from that person. Fortunately, that is not the path corporate law has taken. As this Section and Part II demonstrate, the duty of legal obedience—which overrides other considerations, including the pursuit of profit—is embodied in fundamental notions and doctrines of corporate law itself.

Why did corporate law not stop at personhood, and went on to develop the legal primacy norm? The answer has to do with what Professor Henry Smith, in his recent work on equity, called "intense interactions[, which] can lead to unforeseen and undesired results."¹⁴⁵ The corporate entity operates within a larger structure. Every corporation also has human representatives (directors, officers, and other fiduciaries), and residual claimants (shareholders)—those who stand to receive what would be left after the entity has fulfilled its other, non-corporate obligations.¹⁴⁶

The legal primacy norm, similar to the broader law of corporate purpose, thus operates "to direct and manage the expectancy interests of the corporation's stakeholders."¹⁴⁷ Because legal primacy is a clearly articulated part of corporate law, fiduciaries know (or should know) that they must cause the entity to operate lawfully; and shareholders know (or should know) that they can only receive the residual value left after this requirement has been fully met. Without the legal primacy norm, corporations could act as criminals or civil violators, with the only recourse for injured parties being the collection of the corporation's own assets (which, consistent with Smith's "intense interactions," could easily be smuggled away from the entity once law enforcement closes in).¹⁴⁸ The legal primacy norm extends the obedience and compliance function into corporate law, using its distinctive tools of equity and fiduciary duty,

as the New Corporate Law, 23 CARDOZO L. REV. 325, 328 (2001) ("Laws offering models for business organizations . . . cover *relationships between the interested parties within the organizations* None of these laws, however, regulates the *businesses in which the organizations engage*. Those . . . businesses are regulated by other laws, unrelated to [their] organizational structures").

145. Smith, *supra* note 42, at 1056.

146. See *supra* notes 108–25 and accompanying text.

147. Fisch & Solomon, *supra* note 8, at 1339. Professors Fisch and Solomon might be using the term "stakeholders" in the narrow sense, referring only to the corporation's non-residual claimants (which is also the meaning employed in this Article). However, in this specific quote, it is actually more useful to think of "stakeholders" in the broad sense, as "any group or individual who can affect or is affected by the achievement of the organization's objectives," R. EDWARD FREEMAN, STRATEGIC MANAGEMENT: A STAKEHOLDER APPROACH 46 (1984).

148. Corporate law's response to this possibility is demonstrated, for example, by the prohibition on paying dividends, or making share buybacks, when those might imperil the entity's ability to meet its obligations to stakeholders. See *infra* Section II.C.

and in a manner that binds both the entity, its human representatives, and its residual claimants.

At the highest taxonomic level, the ways in which legal primacy manifests can be divided into “declarative” and “operative” norms. The declarative norms are various statements, found in corporate law statutes or cases, which entail that the corporate entity must obey the law (often adding that this comes before the pursuit of profit). This set of norms is discussed in the remainder of this Section. The other group—operative norms, such as fiduciary good faith, the *Caremark* doctrine, and the mandatory limits on dividends and buybacks—are examined in Part II.

By themselves, the declarative parts of legal primacy seem very hard, if not impossible, to use for obtaining a remedy in court. That is because the entity is already subject to non-corporate law, and if it breaches any of those external laws (for example, commits a tort), an enforcement action can usually be brought within that framework. A stakeholder suing the entity under corporate law’s declarative legal primacy provisions, as well, would be seeking forbidden double recovery. The declarative norms, however, do serve a practical purpose: they clarify that the corporation is operating within a broader legal system and society, and that despite the traditional focus on “profit,”¹⁴⁹ legal obedience is part of black-letter corporate law. These important statements therefore animate the other, operative norms, which *can* directly be invoked in a corporate law courtroom.

It makes sense to begin with the leading corporate law statutes. The two opening sections of the Delaware General Corporation Law clearly convey the requirement of legal obedience. Section 101(b) declares that “[a] corporation may be incorporated or organized under this chapter to conduct or promote any lawful business or purposes.”¹⁵⁰ Section 102(a)(3) adds that, when stating the corporation’s goals¹⁵¹ in the certificate of incorporation, “[i]t shall be sufficient to state . . . that the

149. See *infra* Section III.A.

150. DEL. CODE ANN. tit. 8, § 101(b) (2022).

151. The Delaware statute uses the word “purpose” to refer to the corporation’s operating goals (for example, a corporate charter may state that the corporation’s “purpose” is “to engage in construction”). However, this is a different meaning than the more recent usage (also adopted in this Article), which refers to a broader concept, such as “for-profit,” “nonprofit,” “benefit corporation” and so forth. This point is far from purely linguistic: misconstruing the type of “purpose” being discussed can lead to broken, ineffective discourse. For more on this distinction, see David Kershaw & Edmund Schuster, *The Purposive Transformation of Corporate Law*, 69 AM. J. COMPAR. L. 478, 484–94 (2021); George A. Mocsary, *Freedom of Corporate Purpose*, 2016 B.Y.U. L. REV. 1319, 1364–68 (discussing the difference between “strategic” and “tactical” corporate purpose, similar to the distinction made here between “purpose” and “goals”); Elizabeth Pollman, *The History and Revival of the Corporate Purpose Clause*, 99 TEX. L. REV. 1423 (2021) (discussing corporate purpose, in the sense of the corporation’s operating goals, from early corporate charters through the nineteenth century and into the modern era); *Raz*, *supra* note 19, at 535.

purpose of the corporation is to engage in any lawful act or activity . . . , and by such statement all lawful acts and activities shall be within the purposes of the corporation.”¹⁵² At present, the majority of Delaware corporations have indeed adopted the “any lawful act or activity” provision in their charter.¹⁵³

Similarly, the Model Business Corporation Act declares that, unless a narrower goal is specified in its charter, “[e]very corporation incorporated under this Act has the purpose of engaging in any lawful business”;¹⁵⁴ and the American Law Institute’s Principles of Corporate Governance states: “Even if corporate profit and shareholder gain are not thereby enhanced, the corporation, in the conduct of its business . . . [i]s obliged, to the same extent as a natural person, to act within the boundaries set by law.”¹⁵⁵

Corporate law’s requirement of lawful behavior extends from legislation to a multitude of judicial cases. Here, as can be expected, there is often a mix between declarative and operative statements of legal primacy: courts mention that the corporate *entity* may pursue profit only within the bounds of law, and they do so in the context of a lawsuit for breach of *directors’* fiduciary duties—specifically, their duty of good faith.¹⁵⁶ Consider, for example, then–Vice Chancellor Strine in the case of *Massey Energy*:¹⁵⁷

Delaware law allows corporations to pursue diverse means to make a profit, subject to . . . the requirement that Delaware corporations only pursue “lawful business” by “lawful acts.” As a result, a fiduciary of a Delaware corporation cannot be loyal to a Delaware corporation by knowingly causing it to seek profit by violating the law.¹⁵⁸

Strine reached similar conclusions in several other Chancery cases, stating, for instance: “[O]ne cannot act loyally as a corporate director by causing the corporation to violate the positive laws it is obliged to obey”;¹⁵⁹ “[u]nder Delaware law, a fiduciary may not choose to manage

152. Tit. 8, § 102(a)(3).

153. See, e.g., Pollman, *supra* note 151, at 1448.

154. MODEL BUS. CORP. ACT § 3.01(a) (AM. BAR ASS’N 2016).

155. PRINCIPLES OF CORP. GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 2.01(b) (AM. L. INST. 1994).

156. See *infra* Section II.A.

157. *In re Massey Energy Co. Derivative & Class Action Litig.*, C.A. No. 5430-VCS, 2011 Del. Ch. LEXIS 83 (Del. Ch. May 31, 2011).

158. *Id.* at *73–74 (footnote omitted) (quoting DEL. CODE ANN. tit. 8, §§ 101(b), 102(a)(3) (2022)).

159. *Guttman v. Huang*, 823 A.2d 492, 506 n.34 (Del. Ch. 2003). Strine added that “[m]any recent events have only emphasized the importance of that obvious component of the duty of loyalty,” *id.*, likely referring to the 2001–2002 Enron scandal. Two decades later, such concerns seem only to have amplified.

an entity in an illegal fashion, even if the fiduciary believes that the illegal activity will result in profits for the entity”;¹⁶⁰ and “[a]lthough directors have wide authority to take lawful action on behalf of the corporation, they have no authority knowingly to cause the corporation to become a rogue [I]t is utterly inconsistent with one’s duty of fidelity to the corporation to consciously cause the corporation to act unlawfully.”¹⁶¹ Years later, this deep-seated recognition of legal primacy likely contributed to Chief Justice Strine’s reinvigoration of the *Caremark* doctrine.¹⁶²

Federal courts have similarly invoked the legal primacy norm. For example, in *Miller v. AT&T*,¹⁶³ the U.S. Court of Appeals for the Third Circuit held that directors, who allegedly caused the corporation to engage in a form of unlawful political donation, may have breached their duties: “[A]pplication of the sound business judgment rule would [have supported a dismissal of the complaint]. . . . Where, however, the [directors’] decision . . . is itself alleged to have been an illegal act, different rules apply. . . . [E]ven though committed to benefit the corporation, illegal acts may amount to a breach of fiduciary duty.”¹⁶⁴

These legislative and judicial declarations clearly establish a form of an “absolute priority rule”: as a matter of corporate law’s internal structure—indeed, as a matter of corporate *purpose*—corporations are required to obey external, non-corporate law, and to place this before any other consideration, including the pursuit of profit.¹⁶⁵ As Chief Justice Strine and other leading Delaware jurists correctly stated, “American corporate law embeds law compliance within the very mission of the corporation. Loyalty to the corporation’s obligation as a citizen to attempt in good faith to abide by the law is not incidental to a director’s duties, it is fundamental.”¹⁶⁶

Put differently, corporate law creates a preliminary, binding fact: it is *not* in the benefit (or fiduciary best interest) of the entity to obtain profit, if that profit is achieved through some gap in law enforcement, whether civil or criminal, private or public law. This is profoundly different from the oft-prevailing focus on economic gain, with little regard for how such

160. *Metro Commc’n Corp. BVI v. Advanced Mobilecomm Techs. Inc.*, 854 A.2d 121, 131 (Del. Ch. 2004).

161. *Desimone v. Barrows*, 924 A.2d 908, 934 (Del. Ch. 2007).

162. *See infra* Section II.B (discussing the revitalization of the *Caremark* doctrine following Chief Justice Strine’s opinion for the court in *Marchand v. Barnhill*, 212 A.3d 805 (Del. 2019)).

163. 507 F.2d 759 (3d Cir. 1974).

164. *Id.* at 762.

165. *See Raz, supra* note 19 *passim* (stating that the purpose of a for-profit corporation is the “lawful pursuit of profit” (emphasis added)).

166. Leo E. Strine, Jr., Lawrence A. Hamermesh, R. Franklin Balotti & Jeffrey M. Gorris, *Loyalty’s Core Demand: The Defining Role of Good Faith in Corporation Law*, 98 GEO. L.J. 629, 653 n.71 (2010).

gain was accomplished.¹⁶⁷ Importantly, it is also an example of Professor Coase's observation that law comes before, and shapes, economics.¹⁶⁸

As mentioned above, these declarative provisions, standing alone, cannot be pled in a corporate law courtroom. To enforce the legal primacy norm—which courts are now doing with increasing frequency—a set of additional tools are required. Part II discusses these operative norms, connecting them with the broader conceptual model offered in this Article, and providing several organizing principles to chart a clearer path for the quickly evolving law in this area.

II. HOW LEGAL PRIMACY WORKS IN PRACTICE

This Part identifies six corporate law doctrines—specifically, in Delaware law¹⁶⁹—that form the operative, enforceable aspect of the legal primacy norm. These include the fiduciary duty of good faith,¹⁷⁰ directors' oversight duties,¹⁷¹ the mandatory limits on dividends and buybacks,¹⁷² the shift in corporate purpose in the vicinity of insolvency,¹⁷³ the seniority of preferred shareholders and trust shareholders,¹⁷⁴ and the judicial dissolution of law-breaking corporations.¹⁷⁵ So far, corporate law scholarship has placed these topics in separate silos, but this Article aims to demonstrate that they are all facets of corporate law's structural commitment to rule of law principles and stakeholders' rights.

The discussion in this Part does not delve into every doctrinal intricacy of these well-recognized features of corporate law. Instead, the following six Sections are meant to illustrate, in a fairly concise manner, how their respective doctrines apply the principles of legal primacy, explored throughout this Article. First, all of these legal devices are part of corporate law, enforced in corporate law courts, and impose liability

167. See *infra* Section III.A.

168. See Ronald H. Coase, *The Institutional Structure of Production: Lecture to the Memory of Alfred Nobel*, NOBEL PRIZE (Dec. 9, 1991), <https://www.nobelprize.org/prizes/economic-sciences/1991/coase/lecture> [<https://perma.cc/E8SA-44FM>] (“[T]he legal system [has] a profound effect on the working of the economic system and may in certain respects be said to control it.”); see also Raz, *supra* note 26, at 264–65 (discussing Coase and other scholars who argue that law is a pre-existing frame of reference for economics).

169. Although this Part focuses on Delaware, the doctrines it surveys have equivalents in other U.S. and global jurisdictions. See, e.g., *infra* notes 243, 254, 270, 281. The legal primacy norm is the product of fundamental legal concepts that apply globally, and it should continue to be developed by lawmakers, and studied by scholars, across the world.

170. See *infra* Section II.A.

171. See *infra* Section II.B.

172. See *infra* Section II.C.

173. See *infra* Section II.D.

174. See *infra* Section II.E.

175. See *infra* Section II.F.

based on corporate-specific concepts of equity and fiduciary duty.¹⁷⁶ Second, these doctrines all take the rights of *stakeholders* as the analytical starting point, subordinating both the corporation's pursuit of profit, and shareholders' ability to enjoy those profits, to the fulfillment of stakeholders' claims. The existing paradigm, depicting corporate law as concerned mainly with agency costs between shareholders and managers,¹⁷⁷ does not accommodate these highly salient aspects of corporate law, and should be revisited. Third, these tools all require the existence of an initial *legal* claim on the part of stakeholders (specifically, one arising outside of corporate law), as opposed to an extra-legal demand, or a wish to see the law change in some way.

In this manner, the legal primacy norm creates an "ex ante island" within corporate law's mostly ex post ocean.¹⁷⁸ In this island, entities and stakeholders are endowed with a relatively low-information-cost, high-enforceability means—not foreclosed by the business judgment rule, or other fiduciary-protective devices—to acquire remedy after a legal incursion has occurred. As the following Sections demonstrate, many of these doctrines are making their way to the center of corporate law practice and litigation; the Delaware courts, more frequently than ever before, utilize them to impose liability of considerable monetary scope. The theory offered in this Article explains why these courts—like corporate policymakers elsewhere in the United States and globally—*should* continue vigorously doing so.

A. *Fiduciary Good Faith and the Duty of Obedience*

In the well-known case of *Stone v. Ritter*,¹⁷⁹ the Delaware Supreme Court refined the contours of corporate fiduciary law, declaring that a fiduciary's duty of loyalty—the core obligation of any fiduciary, within corporate law or otherwise, in Delaware and elsewhere¹⁸⁰—includes a

176. The final device—judicial dissolution of law-breaking corporations, *see infra* Section II.F—distinctively implicates another corporate-specific concept: the corporation's personhood.

177. *See supra* notes 4–5 and accompanying text; *infra* text accompanying notes 342–45.

178. *Cf. Rock & Wachter, supra* note 38, at 1674 & *passim* (describing corporations as "islands of conscious power," while noting that violations of law should remain an exception to this power).

179. 911 A.2d 362 (Del. 2006).

180. *See, e.g., Bristol & W. Bldg. Soc'y v. Mothew* [1996] EWCA (Civ) 533, [1998] Ch 1, 18 (appeal taken from Eng.) ("The distinguishing obligation of a fiduciary is the obligation of loyalty. The principal is entitled to the single-minded loyalty of his fiduciary."); Andrew S. Gold & Paul B. Miller, *Introduction*, in *PHILOSOPHICAL FOUNDATIONS OF FIDUCIARY LAW* 1, 1 (Andrew S. Gold & Paul B. Miller eds., 2014) ("There is little doubt that fiduciary relationships generate at least one distinctive legal duty, the duty of loyalty.").

“subsidiary element” of “good faith.”¹⁸¹ Crucially, the court reiterated that “[a] failure to act in good faith may be shown, for instance, where the fiduciary intentionally acts with a purpose other than that of advancing the best interests of the corporation, [or] where the fiduciary *acts with the intent to violate applicable positive law.*”¹⁸²

This statement underscores the framework offered in this Article in two principal ways. First, even beyond the scope of legal primacy alone, it recognizes the broader structural elements of corporate law, discussed in Section I.B: namely, that the corporation is a purposeful, free-acting entity. Accordingly, its fiduciaries cannot fulfill their duty of loyalty by sitting back and doing nothing, even if they derive no personal benefit in the process.¹⁸³ Instead, corporate law fiduciaries must *actively* operate to promote the corporation’s purpose: “[T]he director’s job demands affirmative action—to protect and to better the position of the corporation.”¹⁸⁴

Second, and specifically related to legal primacy, it is no accident that the Delaware courts in the *Disney* and *Stone* line of cases emphasized the rule against “violat[ing] applicable positive law”¹⁸⁵ as inherent to fiduciary good faith. The reason is that the corporation’s purpose, which directors are duty-bound to advance, has to be lawful.¹⁸⁶ “Law compliance thus comes ahead of profit-seeking as a matter of the

181. *Stone*, 911 A.2d at 370 (“[T]he requirement to act in good faith ‘is a subsidiary element[,]’ i.e., a condition, ‘of the fundamental duty of loyalty.’” (alteration in original) (quoting *Guttman v. Huang*, 823 A.2d 492, 506 n.34 (Del. Ch. 2003))).

182. *Id.* at 369 (emphasis added) (quoting *Brehm v. Eisner* (*In re Walt Disney Co. Derivative Litig.*), 906 A.2d 27, 67 (Del. 2006) (quoting *In re Walt Disney Co. Derivative Litig.*, 907 A.2d 693, 755 (Del. Ch. 2005))).

183. *See, e.g., id.* at 370 (“[T]he fiduciary duty of loyalty is not limited to cases involving a financial or other cognizable fiduciary conflict of interest.”); *Brehm v. Eisner*, 906 A.2d at 66 (“[T]he universe of fiduciary misconduct is not limited to either disloyalty in the classic sense (*i.e.*, preferring the adverse self-interest of the fiduciary or of a related person to the interest of the corporation) or gross negligence. Cases have arisen where corporate directors have no conflicting self-interest in a decision, yet engage in misconduct [F]iduciary conduct of this kind, which does not involve disloyalty (as traditionally defined) . . . , should be proscribed. A vehicle is needed to address such violations doctrinally, and that doctrinal vehicle is the duty to act in good faith.”).

184. Strine et al., *supra* note 166, at 636. Corporate law thus makes a clear choice regarding the distinction offered by Professor George Fletcher, between “minimal loyalty” and “maximum loyalty,” GEORGE P. FLETCHER, *LOYALTY: AN ESSAY ON THE MORALITY OF RELATIONSHIPS* 41, 61 (paperback ed. 1995). A similar concept to Fletcher’s maximum loyalty, and Delaware’s affirmative devotion, appears in Professor Arthur Laby’s work on loyalty as the adoption of ends. *See* Arthur B. Laby, *The Fiduciary Obligation as the Adoption of Ends*, 56 *BUFF. L. REV.* 99 (2008).

185. *Stone*, 911 A.2d at 369 (quoting *Brehm v. Eisner*, 906 A.2d at 67 (quoting *Disney Post-Trial Chancery Opinion*, 907 A.2d at 755)).

186. *See supra* Section I.C.

corporation's mission, and directors owe a duty of loyalty to that hierarchy."¹⁸⁷

While the corporation is a purposeful and active legal person, its open-ended endeavors are constrained by its legal obligations. The legal primacy norm, manifesting through the doctrine of fiduciary good faith, endows the corporation with a self-standing cause of action against its fiduciaries: even if directors, officers, or other fiduciaries honestly operated to maximize corporate profit, this does not mean they acted loyally (that is, to promote the corporation's purpose), if the activity at issue was not a *lawful* one.¹⁸⁸

Moreover, disloyal fiduciaries—including those who act with lack of good faith under *Stone* (and its doctrinal extensions, namely *Caremark*¹⁸⁹)—lose their two most important liability shields: first, the business judgment rule,¹⁹⁰ and second, Section 102(b)(7),¹⁹¹ which provides that a corporate charter may “eliminat[e] or limit[] the personal liability of a director,”¹⁹² but such exculpation cannot cover “acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law.”¹⁹³

This leads to a thorny question: why does a failure to make the corporation act lawfully give rise to a breach of the duty of *loyalty*, rather than the (much more laxly enforced) duty of *care*?¹⁹⁴ After all, directors and officers do not necessarily collect anything into their pockets when the corporation breaks the law. Presumably, the corporation—to which they owe their loyalty—might make *more* profit in such a situation, with the only externality being toward stakeholders (employees, creditors, or others). Why, then, should those fiduciaries be exposed to liability, with no protection from the business judgment rule or Section 102(b)(7)?

The answer involves some deep-seated aspects of legal theory, extending beyond corporate law itself. As Professor Ronald Coase, a founding figure of the law and economics movement, said in his 1991 Nobel Prize lecture, “the legal system [has] a profound effect on the

187. Strine et al., *supra* note 166, at 651.

188. See, e.g., Andrew S. Gold, *The New Concept of Loyalty in Corporate Law*, 43 U.C. DAVIS L. REV. 457, 475–77 (2009); *supra* notes 157–61 and accompanying text (citing multiple Delaware cases that emphasize this point).

189. See *infra* Section II.B.

190. See, e.g., *Gagliardi v. Trifoods Int'l, Inc.*, 683 A.2d 1049, 1051 (Del. Ch. 1996) (“[I]n the absence of facts showing self-dealing or improper motive, a corporate officer or director is not legally responsible to the corporation for losses that may be suffered as a result of a decision that an officer made or that directors authorized *in good faith*.” (emphasis added)).

191. DEL. CODE ANN. tit. 8, § 102(b)(7) (2022).

192. *Id.*

193. *Id.*

194. For discussion of recent scholarship that criticizes the view of legal non-compliance as a breach of the duty of loyalty (rather than care), see *infra* notes 337–41 and accompanying text.

working of the economic system and may in certain respects be said to control it.”¹⁹⁵ Accordingly, *law* can create or command some facts, even if they do not originate in economic theory, or are perhaps of lesser interest to an economist than to a lawmaker. One of those facts is that the corporation’s purpose—which directors’ duty of loyalty requires advancing—is not merely the pursuit of profit, but the *lawful* pursuit of profit. Loyally serving the corporation includes causing it to act in a law-abiding manner, independently of any economic calculation that might point in a different direction.

Moreover, because the loyalty required by corporate law is of the “affirmative devotion” kind¹⁹⁶—which does not stop merely at lack of self-interest—it is of no consequence whether the fiduciary made any personal gain in the process. It might seem harsh that an unconflicted fiduciary can be deemed disloyal, and face liability without the benefit of fiduciary-protective devices. Yet, this legal choice is entirely reasonable, even from an economic perspective: just as the “self-interest” prong deters managers from expropriating the corporation’s assets, so does the “lawfulness” prong deter managers from violating their *Stone* duties, or the other legal primacy doctrines discussed in the following Sections.

As a result, corporations are more likely to operate lawfully, and harmful externalities can be minimized *ex ante*. Fiduciaries who do not wish to be subject to unexculpated liability should not act in a self-interested manner—and, equally, should do an adequate job in causing the corporation to abide by its legal duties. While corporate fiduciaries’ *business* decisions are practically subject to no judicial oversight,¹⁹⁷ disobeying the law is simply not a business decision.¹⁹⁸ Accordingly, there is no fundamental problem—theoretical, practical, or economic—with subjecting fiduciaries to an effective liability regime in this area.

B. Directors’ Oversight Duties

Of the six doctrines discussed in this Part, the most visible and well-recognized might be the recent reinvigoration, in both judicial and scholarly writing, of the doctrine established in the 1996 *Caremark*¹⁹⁹ decision. Beginning in mid-2019, an increasing number of high-profile cases, grounded in *Caremark* claims, have survived motions to dismiss

195. Coase, *supra* note 168.

196. *See supra* notes 183–84 and accompanying text.

197. For an article that concisely makes this point, see Edward Rock & Michael Wachter, *Dangerous Liaisons: Corporate Law, Trust Law, and Interdoctrinal Legal Transplants*, 96 NW. U. L. REV. 651, 651, 657–59 (2002) (explaining that directors have almost never been held liable for a breach of the duty of care alone).

198. *See, e.g.*, Rock & Wachter, *supra* note 38, at 1674.

199. *In re Caremark Int’l Inc. Derivative Litig.*, 698 A.2d 959 (Del. Ch. 1996).

in the Delaware courts.²⁰⁰ That is so despite *Caremark* originally being described as “possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment.”²⁰¹ This Section situates *Caremark* and its progeny as an application of the legal primacy norm. Without this underlying principle, the powerful *Caremark* doctrine—departing from Delaware’s usual emphasis on the business judgment rule—cannot be adequately understood. At the same time, this Section also explains why *Caremark* claims should remain *relatively* difficult to prove in court, compared to most other legal primacy devices discussed in this Article.²⁰²

The *Caremark* doctrine owes its existence to a well-established fact of modern life: many corporations are big, hierarchical organizations.²⁰³ If the daily affairs of every corporation were directly managed by its highest-level fiduciaries, there would be no need for *Caremark*; only the *Stone* doctrine, discussed in the previous Section, would be required, as it imposes liability on directors and officers for *personally* acting “with the intent to violate applicable positive law.”²⁰⁴ Indeed, this might still be the case in many small or closely-held corporations.

More commonly, corporations operate through a large number of employees and other agents. Imposing liability on the corporation’s directors for any legal incursion would be overly restrictive, perhaps even punitive. Directors cannot possibly know about every act of non-

200. See, e.g., *Marchand v. Barnhill*, 212 A.3d 805, 820–24 (Del. 2019); *In re Boeing Co. Derivative Litig.*, C.A. No. 2019-0907-MTZ, 2021 Del. Ch. LEXIS 197, at *69–93 (Del. Ch. Sept. 7, 2021); *In re Clovis Oncology, Inc. Derivative Litig.*, Consol. C.A. No. 2017-0222-JRS, 2019 Del. Ch. LEXIS 1293, at *25–32 (Del. Ch. Oct. 1, 2019). For detailed discussion of many additional cases, see Roy Shapira, *A New Caremark Era: Causes and Consequences*, 98 WASH. U. L. REV. 1857 (2021).

201. *Caremark*, 698 A.2d at 967.

202. From a normative standpoint, the one doctrine that should perhaps remain harder to prove than *Caremark* is the dissolution remedy, see *infra* Section II.F. The other devices discussed in this Part—fiduciary good faith, the mandatory limits on dividends and buybacks, the shift in corporate purpose in the vicinity of insolvency, and the seniority of preferred shareholders and trust shareholders—generally involve fiduciary acts or omissions that *directly* cause the corporation to violate the law, and so do not raise the same difficulty as *Caremark*.

203. See, e.g., Matthew T. Bodie, *Holacracy and the Law*, 42 DEL. J. CORP. L. 619, 620–21 (2018) (“Ever since the development of the modern corporation, the law has assumed a hierarchical approach to internal corporate governance. Corporations are ruled by a board of directors that sits atop the hierarchy. The board delegates governance responsibilities The chief executive officer has ultimate managerial power, with other officers below, and then executives, managers, and the mass of workers known simply as employees.” (footnote omitted)).

204. *Stone v. Ritter*, 911 A.2d 362, 369 (Del. 2006) (quoting *Brehm v. Eisner (In re Walt Disney Co. Derivative Litig.)*, 906 A.2d 27, 67 (Del. 2006) (quoting *In re Walt Disney Co. Derivative Litig.*, 907 A.2d 693, 755 (Del. Ch. 2005))).

compliance occurring down the corporate hierarchy.²⁰⁵ This does not mean, however, that directors get a free pass to manage a rogue, law-breaking corporation. As *Caremark* clarifies, what directors can and must do is create a system of *monitoring* over the corporation's legal compliance: "[It is an] elementary fact that relevant and timely *information* is an essential predicate for satisfaction of the board's supervisory and monitoring role under [Delaware corporate law]."²⁰⁶

From the time it appeared in 1996, and until 2019, the *Caremark* doctrine lay relatively dormant; Chancellor Allen's statement regarding "the most difficult theory . . . upon which a plaintiff might hope to win a judgment"²⁰⁷ was taken at face value. Although the 2006 *Stone*²⁰⁸ case, where the Delaware Supreme Court declared legal compliance to be part of directors' duty of loyalty,²⁰⁹ was itself premised on a *Caremark* claim,²¹⁰ most lawsuits of this kind were dismissed in the early stages of litigation.²¹¹ Yet, as a matter of principle, it is not clear why that should be the case. Assuming there are at least some situations where the business judgment rule does not apply,²¹² a good place to start would be with violations of the compliance duty—which enjoys a senior position in the hierarchy of corporate loyalty²¹³—no less than we accept litigation over the more "traditional" form of disloyalty (self-dealing or conflict of interest).

The Delaware courts ultimately came to realize this. In the summer of 2019, *Caremark* emerged from its slumber, in *Marchand v. Barnhill*.²¹⁴ There, in an opinion written by Chief Justice Strine, the Delaware Supreme Court stated as follows:

205. Consistent with the broader structure discussed in this Article, this fact does not exculpate the corporate *entity* from liability for the misconduct caused by the employee or other agent, *outside* of corporate law. *See, e.g.,* City of Detroit Police & Fire Ret. Sys. v. Hamrock, C.A. No. 2021-0370-KSJM, 2022 Del. Ch. LEXIS 159, at *20–22, *66 (Del. Ch. June 30, 2022) (dismissing *Caremark* lawsuit against a corporation's directors, after the corporation itself has been sanctioned in the amount of \$109 million for violations of an industrial safety statute).

206. *Caremark*, 698 A.2d at 970.

207. *Id.* at 967.

208. 911 A.2d 362.

209. *See supra* notes 179–82 and accompanying text.

210. *See Stone*, 911 A.2d at 364 ("The Court of Chancery characterized the allegations in the derivative complaint [in this case] as a 'classic *Caremark* claim[]' . . .").

211. *See, e.g.,* John Armour, Jeffrey Gordon & Geeyoung Min, *Taking Compliance Seriously*, 37 YALE J. ON REGUL. 1, 45–46 (2020).

212. *See, e.g.,* Raz, *supra* note 26, at 240 n.92 ("[T]he [business judgment] rule imposes some conditions (including loyal and informed fiduciary action), comporting with the rest of corporate law's structure. Sometimes, those requirements are *not* met . . .").

213. *See Strine et al., supra* note 166, at 651 ("Law compliance . . . comes ahead of profit-seeking as a matter of the corporation's mission, and directors owe a duty of loyalty to that hierarchy.").

214. 212 A.3d 805 (Del. 2019).

A failure to make that effort [to comply with *Caremark*] constitutes a breach of the duty of loyalty. Where . . . no reasonable compliance system and protocols were established as to the obviously most central consumer safety and legal compliance issue facing the company, . . . resulting in the death and injury of company customers, the plaintiff has met his onerous pleading burden and is entitled to discovery to prove out his claim.²¹⁵

In the three years since *Marchand*, a long series of successful *Caremark* lawsuits followed—part as fiduciary duty complaints,²¹⁶ and part as Section 220 books and records inspection demands.²¹⁷ In the most significant of those cases, the Delaware Court of Chancery refused to dismiss a derivative action against The Boeing Company’s directors,²¹⁸ for their near-total lack of oversight regarding the company’s compliance with safety regulations, leading to two crashes of the 737 MAX airliner, which resulted in 346 fatalities.²¹⁹ In November 2021, the *Boeing* lawsuit settled for \$237.5 million.²²⁰

Perhaps most tellingly, this trend is viewed positively even by those who usually consider the business judgment rule, and other aspects of director independence, to be paramount: in their recent article, criticizing a large number of fiduciary liability-increasing developments in Delaware law, three of Delaware’s leading jurists remain careful *not* to condemn the powerful reinvigoration of *Caremark*’s legal primacy requirement.²²¹ While *Caremark*, relatively speaking, is (and should

215. *Id.* at 824.

216. See Shapira, *supra* note 200, at 1863–66. The term “successful” is used here to refer to cases where the motion to dismiss has been denied, *see id.*, which in Delaware corporate litigation can be viewed, in most cases, as successful adjudication on the merits. For detailed discussion of the trial-like role of the motion to dismiss stage in Delaware law, see Lawrence A. Hamermesh & Michael L. Wachter, *The Importance of Being Dismissive: The Efficiency Role of Pleading Stage Evaluation of Shareholder Litigation*, 42 J. CORP. L. 597 (2017).

217. See Roy Shapira, *Corporate Law, Retooled: How Books and Records Revamped Judicial Oversight*, 42 CARDOZO L. REV. 1949, 1980–82 (2021).

218. *In re Boeing Co. Derivative Litig.*, C.A. No. 2019-0907-MTZ, 2021 Del. Ch. LEXIS 197, at *69–93 (Del. Ch. Sept. 7, 2021).

219. See, e.g., David Shepardson, *Boeing Directors Agree to \$237.5 Million Settlement Over 737 MAX Safety Oversight*, REUTERS (Nov. 5, 2021, 8:28 PM), <https://www.reuters.com/legal/transactional/boeing-directors-agree-2375-million-settlement-over-max-safety-oversight-2021-11-05> [<https://perma.cc/W2AM-WX68>].

220. See *id.* For extended discussion of the *Boeing* case and its role in the development of the *Caremark* doctrine, see Roy Shapira, *Max Oversight Duties: How Boeing Signifies a Shift in Corporate Law*, 48 J. CORP. L. (forthcoming 2023), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4035952 [<https://perma.cc/VL9C-QQWJ>].

221. See Lawrence A. Hamermesh, Jack B. Jacobs & Leo E. Strine, Jr., *Optimizing the World’s Leading Corporate Law: A Twenty-Year Retrospective and Look Ahead*, 77 BUS. LAW. 321 (2022).

remain) the most lenient of the legal primacy doctrines,²²² it now successfully shapes how corporations operate, and will continue doing so in new and evolving ways.²²³ It is the most visible recognition that legal obedience is a self-standing part of the corporation's purpose, independent from the pursuit of profit,²²⁴ and that—given the hierarchical nature of modern corporations—directors' duties must be interpreted accordingly.

C. *The Mandatory Limits on Dividends and Buybacks*

As this Article explains, the corporation's duty to obey the law is grounded in fundamental jurisprudential concepts, including the rule of law, personhood, and the structure of corporate law.²²⁵ The doctrines surveyed in the previous Sections—fiduciary good faith²²⁶ and directors' oversight duties²²⁷—primarily deal with situations where the corporation already *has* violated its non-corporate legal obligations. Yet, the legal primacy norm also includes several more prophylactic doctrines, meant to increase the probability that the corporation complies with its duties, *when* the time comes to do so.²²⁸ The first such doctrine, discussed in this Section, limits the corporation's ability to distribute wealth to its shareholders, when such distribution might endanger its capacity to meet all obligations to stakeholders.

Corporate law's distribution-limiting rules exist for a fairly practical reason: when a person has a legal duty to pay an amount of money (or other form of wealth), that person must have enough financial resources in their disposition to do so. With no money in the debtor's pockets, a loan cannot be repaid, nor can a tort judgment be satisfied.²²⁹ Interestingly, outside of corporate law, there is no equivalent to the rules discussed here: when a natural person borrows money from a bank (for example), the borrower can immediately spend this entire amount, or transfer it as a gift to a family member (unless a different stipulation

222. See *supra* notes 201–02, 205 and accompanying text.

223. See, e.g., E. Paige Williams, *The Writing on the [Fire]wall: "Mission Critical" Cybersecurity Derivative Litigation is on Delaware's Horizon*, 74 FLA. L. REV. 169, 186–203 (2022).

224. See *supra* Sections I.C, II.A.

225. See *supra* Part I.

226. See *supra* Section II.A.

227. See *supra* Section II.B.

228. A similarly prophylactic doctrine is the shift in corporate purpose in the vicinity of insolvency. See *infra* Section II.D.

229. In such a situation, the debtor and creditors might enter the domain of bankruptcy law. Bankruptcy proceedings initiated by debtors, to mitigate large-scale tort liability, are now coming under increased scrutiny. See, e.g., Lindsey D. Simon, *Bankruptcy Grifters*, 131 YALE L.J. 1154 (2022). The legal primacy norm, within corporate law, operates to decrease the probability that insolvency or bankruptcy will occur in the first place.

appears in the loan contract). For humans, the law poses no requirement to maintain a “safety cushion” for the benefit of creditors.

In corporate law, with its emphasis on the primacy of stakeholders’ legal claims, a different picture emerges. As a preliminary note, assets can leave the corporation’s pockets in several ways: first, the corporation might simply lose money in its ongoing business operations. As long as those operations are being carried out according to the dictates of good faith and corporate purpose,²³⁰ the business judgment rule will normally apply, and no corporate claim will accrue to stakeholders, even in case of insolvency.²³¹ Yet, there is an additional process through which assets can depart the corporation: the payment of dividends to shareholders, and the repurchase (or buyback) of shares that they own.

Such transactions differ from regular business operations: under Delaware law, “[t]he directors of every corporation . . . may declare and pay dividends upon the shares of its capital stock,”²³² and “[e]very corporation may purchase . . . its own shares.”²³³ That is, the decision to commence such a transaction is reached at the highest level of the corporate hierarchy, and is largely discretionary. Moreover, dividends and buybacks tend to extract very large amounts of money from the corporate treasury within a short span of time. For example, in 2021 alone, share buybacks by S&P 500 companies totaled approximately \$850 billion.²³⁴

Accordingly, corporate law has much to say about these two types of transactions—mainly from the viewpoint of legal primacy, seeking to prevent a depletion of the corporation’s assets to the detriment of stakeholders. The above-quoted sections of the Delaware statute, immediately after declaring the corporation’s *power* to make a distribution, impose an extensive array of mandatory *conditions* that must be satisfied for the distribution to be lawful.

First, Section 170 instructs that dividends may be paid only “[o]ut of [the corporation’s] surplus,”²³⁵ or “[i]n case there shall be no such surplus, out of [the corporation’s] net profits for the fiscal year in which the dividend is declared and/or the preceding fiscal year.”²³⁶ In turn, “surplus” is defined in the Delaware statute as “[t]he excess . . . of the net assets of the corporation over the amount . . . [of its] capital.”²³⁷

230. See *supra* Sections I.B, II.A.

231. See *infra* Section II.D.

232. DEL. CODE ANN. tit. 8, § 170(a) (2022) (emphases added).

233. *Id.* § 160(a) (emphasis added).

234. See Bob Pisani, *Buybacks Are Poised for a Record Year, But Who Do They Help?*, CNBC (Dec. 30, 2021, 8:02 AM), <https://www.cnbc.com/2021/12/30/buybacks-are-poised-for-a-record-year-but-who-do-they-help.html> [<https://perma.cc/BHU7-JCSY>].

235. Tit. 8, § 170(a)(1).

236. *Id.* § 170(a)(2).

237. *Id.* § 154.

This might initially seem like a puzzling array of words—“surplus,” “capital,” “net assets,” and “net profits”—but, in practice, the latter two concepts are most significant.²³⁸ The corporation’s net assets are “the amount by which total assets exceed total liabilities.”²³⁹ The economic value of the corporation’s assets and liabilities, for purposes of a dividend declaration, is left to directors’ discretion, based on reasonable standards.²⁴⁰ In a more fundamental legal sense (aligning with the conceptual scheme discussed in Section I.A), the corporation’s “liabilities” represent the sum of its non-corporate legal duties: its loan debts, obligations toward employees, tort liabilities (if any), and so forth. Similarly, the corporation’s “assets” are the sum of legal rights attaching to the corporation (or, equivalently, the duties owed *to* it). Finally, “net profit” is the amount by which the corporation’s net assets, minus capital, have grown over a given time period (usually, a fiscal year).

Next, in regard to buybacks, Section 160 provides “that no corporation shall . . . [p]urchase or redeem its own shares of capital stock for cash or

238. In the Delaware corporate statute, the term “capital” refers to a concept of relatively limited practical import. With respect to shares that have “par value,” the capital is, at a minimum, the sum of the par values of the corporation’s issued shares. *See id.* With respect to shares without par value, the capital is “the amount of the consideration [paid] for such shares” (when they were allocated, from the corporation to the initial shareholder, in the primary market). *Id.* The first of these two meanings is largely anachronistic, retaining very little functional significance, because “par value” may be any number chosen by the corporation when creating the shares (such as one cent or one dollar), without regard to any real economic quantity—namely, the price at which the shares were initially issued, their current market price, or the value of shareholders’ equitable claim on the corporation’s net worth. The second meaning is more salient, since it represents an actual economic quantity—what shareholders paid to the corporation for its newly-issued shares, when those were allocated in the primary market. Yet, even this meaning only denotes a subset of the *most* important quantity: the corporation’s net worth, or shareholders’ equity (also called “net assets”), which is simply the corporation’s total assets (positive law rights) minus its total liabilities (non-corporate positive law obligations). *See id.* This is the key number for purposes of creditor protection (as discussed here), and the overall financial health of the corporation. As one typical case says, “[b]ecause [the corporation’s] issued stock has a nominal par value of \$0.01 per share, the surplus calculations . . . effectively boil down to a calculation of [the corporation’s] net assets,” *In re Chemours Co. Derivative Litig.*, Consol. C.A. No. 2020-0786-SG, 2021 Del. Ch. LEXIS 258, at *40 (Del. Ch. Nov. 1, 2021) (emphasis added). Today, it appears that the concept of “par value,” in regard to shares (or other residual claims toward an entity), can be safely abolished by lawmakers. Professor Herbert Hovenkamp offers an illuminating historical explanation—related to the transition from classical to marginal economics—as to why the idea of par value was prominent in the first place, and why it lost valence. *See* HERBERT HOVENKAMP, *THE OPENING OF AMERICAN LAW* 159–71 (2015).

239. Tit. 8, § 154.

240. *See, e.g.,* *Morris v. Standard Gas & Elec. Co.*, 63 A.2d 577, 582 (Del. Ch. 1949) (“[D]irectors are . . . under a duty to evaluate the assets on the basis of acceptable data and by standards which they are entitled to believe reasonably reflect present ‘values.’”); Rock, *supra* note 41, at 1949 (“When the market values of the assets and/or liabilities differ from the book value, the board may revalue the assets and liabilities (upward or downward) on the basis of such information as it considers reliable, with no specific method mandated by the courts.”).

other property when the capital of the corporation is impaired or when such purchase or redemption would cause any impairment of the capital of the corporation.”²⁴¹ Here, a new concept is introduced—“impairment of capital”—which the Delaware Supreme Court has construed in a substantive, creditor-oriented manner, similar to that which applies to dividends under Section 170:

Capital is impaired “if the funds used in the repurchase exceed the amount of the corporation’s ‘surplus,’ defined . . . to mean the excess of net assets over the par value of the corporation’s issued stock.” “Net assets” are defined as “the amount by which total assets exceed total liabilities.” . . . “The General Assembly enacted the statute to prevent boards from draining corporations of assets to the detriment of creditors and the long-term health of the corporation.”²⁴²

Effectively, these two sections (160 and 170) of the Delaware statute—and their equivalents in other jurisdictions²⁴³—divide the corporation’s asset pool into two parts, drawing a sharp line between them: those assets which came to the corporation from its stakeholders, and those which the corporation obtained from its shareholders, or as profits. Shareholders may receive dividends, or have their shares repurchased, *only* with resources coming from the second pool. The first pool is insulated from shareholders’ reach, and dedicated to serving stakeholders’ legal claims.

The alternative source of distribution mentioned in Section 170—the corporation’s “net profits for the fiscal year in which the dividend is declared and/or the preceding fiscal year”²⁴⁴—makes the distribution-limiting rules somewhat more favorable toward shareholders, as it permits dividends even if the corporation’s balance sheet displays negative net assets. Yet, this test only narrows the time window over which the divide between the two pools is made; it does not impair the primacy of stakeholders’ legal claims, but merely gives a fresh start to corporations that have recently become profitable. It also recognizes,

241. Tit. 8, § 160(a).

242. *SV Inv. Partners, LLC v. ThoughtWorks, Inc.*, 37 A.3d 205, 210–11 (Del. 2011) (footnotes omitted) (quoting *Klang v. Smith’s Food & Drug Ctrs., Inc.*, 702 A.2d 150, 153, 154 (Del. 1997); Tit. 8, § 154).

243. *See, e.g.*, MODEL BUS. CORP. ACT § 6.40(c) (AM. BAR ASS’N 2016). The MBCA provides an additional type of distribution-limiting rule: “No distribution may be made if, after giving it effect[,] . . . the corporation would not be able to pay its debts as they become due in the usual course of business.” *Id.* This test looks to the *effects* of a possible distribution, rather than to its *sources* (as in the Delaware statute). *See* Rock, *supra* note 41, at 1948–49.

244. Tit. 8, § 170(a)(2). This is also known as the “nimble dividend test.” *See* Rock, *supra* note 41, at 1949 n.187.

among other things, “that a troubled firm must be able to promise dividends to new equity if it is to issue stock and stave off failure.”²⁴⁵

When the corporation’s directors use their powers to declare such a transaction,²⁴⁶ in violation of the mandatory limits on dividends and buybacks, corporate law imposes substantial penalties, which—similar to fiduciary good faith, or the *Caremark* doctrine²⁴⁷—do not allow for the application of fiduciary-protective devices, such as Section 102(b)(7) and the business judgment rule. Thus, Section 174 provides that, if the distribution-limiting rules are “wilful[ly] or negligent[ly]”²⁴⁸ violated, “the directors . . . shall be jointly and severally liable . . . to the corporation, and to its creditors in the event of its dissolution or insolvency, to the full amount of the dividend unlawfully paid, or to the full amount unlawfully paid for the purchase or redemption of the corporation’s stock.”²⁴⁹ Delaware’s well-known Section 102(b)(7) clarifies that, although a corporation’s charter may contain “[a] provision eliminating or limiting the personal liability of a director,”²⁵⁰ such a provision “shall not eliminate or limit the liability of a director . . . under § 174 of this title.”²⁵¹ The business judgment rule equally does not apply.²⁵²

Importantly, the liability imposed by the distribution-limiting rules does not stop with directors: it also extends to shareholders who *received* the unlawful dividend or buyback proceeds. As Section 174 adds, “[a]ny director against whom a claim is successfully asserted . . . shall be entitled . . . to be subrogated to the rights of the corporation against stockholders who received the dividend on, or assets for the sale or redemption of, their

245. Rock, *supra* note 41, at 1949 n.187.

246. See *supra* notes 232–33 and accompanying text.

247. See *supra* Sections II.A, II.B.

248. Tit. 8, § 174(a).

249. *Id.*

250. *Id.* § 102(b)(7).

251. *Id.*

252. The inapplicability of the business judgment rule can be inferred from the statement that “the directors . . . shall be . . . liable,” *id.* § 174(a), creating an independent cause of action, which exists alongside the general tests for breach of the duty of loyalty (those invoked in the more common scenarios where the business judgment rule does not apply). See, e.g., *Quadrant Structured Prods. Co. v. Vertin*, 102 A.3d 155, 202 (Del. Ch. 2014) (distinguishing between “the framework . . . [of] breach of fiduciary duty” and that of Section 174); *In re Chemours Co. Derivative Litig.*, Consol. C.A. No. 2020-0786-SG, 2021 Del. Ch. LEXIS 258, at *2–3 (Del. Ch. Nov. 1, 2021) (“Section 174 . . . appears to impose strict and several liability on any director vicariously for the negligence of another corporate actor as well as for her own negligence, and impose as damages the full amount paid out even if no actual harm to the corporate interest ultimately manifests itself.”). In the latter case, the court dismissed the lawsuit following an analysis that proceeded internally to the distribution-limiting rules (specifically, tit. 8, § 172), and not according to the business judgment rule. See *Chemours*, 2021 Del. Ch. LEXIS 258, at *37–60.

stock with knowledge of facts indicating that such [distribution] was unlawful.”²⁵³ By its language, this provision is particularly applicable to controlling shareholders, or others with close knowledge of the corporation’s financial situation. From an economic perspective, this rule is significant, because it shifts the monetary burden from the directors who authorized the distribution to (at least some of) the people who actually hold the assets at controversy.²⁵⁴ This, again, is a clear illustration of corporate law being characterized not by shareholder primacy, but quite the opposite—shareholder subordination to the legal claims of stakeholders.

Indeed, when one takes a systemic view of the statutory and case law provisions described above, and connects them with the broader framework discussed in this Article, these distribution-limiting rules provide a leading example of the legal primacy norm in practice. Most importantly, these provisions demonstrate that corporate law is not just about shareholders, but takes the protection of stakeholders’ rights as its analytical starting point. Conceivably, in many situations, shareholders would love to receive a large dividend payment, or have their shares repurchased, even if it left the corporation empty-pocketed and unable to fulfill its liabilities. Under the well-established doctrines surveyed in this Section, corporate law mandatorily prohibits such a move, while imposing meaningful, enforceable penalties on fiduciaries and shareholders, aimed at maximizing the corporation’s ability to meet its obligations to a third, prominent group: stakeholders.

D. *The Shift in Corporate Purpose in the Vicinity of Insolvency*

Corporations, like individuals, can fail in their endeavors. As a result of the open-endedness principle,²⁵⁵ it is neither possible, nor advisable to try, to tell the corporation’s fortunes in advance. Corporations may navigate through a wide range of financial situations, without any

253. Tit. 8, § 174(c).

254. Note, however, that the Delaware statutory rule contains a substantial gap: the sums which shareholders are required to repay to the corporation, following an unlawful distribution, are limited “to the extent of the amount paid by [the] director as a result of such claim.” *Id.* Yet, if a shareholder knew that the distribution was unlawful, and received a certain amount from the corporation, there is no good policy reason to limit the corporation’s recovery to the sum paid by a *third* person (the director). That sum might also be limited by factors such as the fact that the director does not possess the distributed money, and the manner in which this shapes the court’s judgment or settlement. Accordingly, the statute ought to be amended to sever this link, and create a fully self-standing cause of action against a knowing shareholder. This approach has been adopted, for example, in U.K. corporate law. See Companies Act 2006, c. 46 § 847(2) (UK) (“If at the time of the distribution the member knows or has reasonable grounds for believing that it is . . . made [in contravention of this Part], he is liable . . . to repay it . . . to the company . . .”).

255. See *supra* text accompanying notes 82–102 (discussing the open-endedness principle and some of the corporate law doctrines that support it).

alteration to the corporate law framework that governs their activities—including the corporation’s purpose, and the broad applicability of the business judgment rule.

Yet, when a corporation reaches, or (in some cases) is about to reach, the point of insolvency—where it is unable to meet its obligations to stakeholders, even if it wanted to—corporate law does not wait on the sidelines. At that stage, corporate law commands a shift in the corporation’s purpose: instead of operating in the open-ended, highly entrepreneurial manner that is generally mandated under corporate law, the corporation’s purpose transforms into a more custodial one, meant to preserve the corporation’s existing resources.²⁵⁶ The distressed corporation might also attempt to increase its net value—but not, for example, by undertaking new projects, as a healthy entity could.²⁵⁷

This Section addresses two issues relating to corporate law in the insolvency context: first is the interface between corporate purpose, fiduciary duties, and the corporation’s entity nature, which seems to remain surrounded by misconceptions, in the insolvency area more than in other corporate law settings. The second issue is specific adjustments that should be made in Delaware law, to make the vicinity of insolvency more congruent with corporate law outside of it. Delaware’s existing doctrines have a sound foundation, but require some corrections to fully catch up to the world of *Stone*,²⁵⁸ *Caremark*,²⁵⁹ and the legal primacy of stakeholders’ rights in general.

To start with, the above-described shift in corporate *purpose* does not change the recipient of *fiduciary* duties, which remains the corporate entity.²⁶⁰ This tenet of corporate law stays intact: the direct legal relationship is between the corporation and its fiduciaries,²⁶¹ and fiduciary duties do not directly run to either shareholders *or* stakeholders.²⁶² The directors’ and officers’ duty continues to be the

256. See Amir N. Licht, *My Creditor’s Keeper: Escalation of Commitment and Custodial Fiduciary Duties in the Vicinity of Insolvency*, 98 WASH. U. L. REV. 1731 (2021).

257. See *id.* at 1733 (“[When] the mission of directors . . . transform[s] from entrepreneurial to custodial[,] . . . they should implement strategies that aim to preserve the firm—in working condition, to the extent possible, with a view to resuming regular business—but avoid seeking new projects with a view toward maximizing profits.”).

258. *Stone v. Ritter*, 911 A.2d 362 (Del. 2006).

259. *In re Caremark Int’l Inc. Derivative Litig.*, 698 A.2d 959 (Del. Ch. 1996).

260. See, e.g., *N. Am. Cath. Educ. Programming Found., Inc. v. Gheewalla*, 930 A.2d 92, 101–03 (Del. 2007) (“It is well settled that directors owe fiduciary duties to the corporation [either when it is solvent or insolvent]. . . . [D]irectors . . . have a fiduciary duty to exercise their business judgment in the best interest of the insolvent corporation.”); *Quadrant Structured Prods. Co. v. Vertin*, 102 A.3d 155, 176 (Del. Ch. 2014) (“The fiduciary duties that creditors gain derivative standing to enforce are not special duties to creditors, but rather the fiduciary duties that directors owe to the corporation . . .”).

261. See *supra* Sections I.B, II.A.

262. See, e.g., *infra* note 335 and accompanying text.

promotion of the corporation's purpose, although the purpose itself has (at least temporarily) changed.

The shift in corporate purpose is related to, but separate from, the distinction between shareholders and stakeholders in situations of insolvency: the former, as *residual* claimants, are entitled to no economic value at all, as long as the corporation cannot fully meet its other obligations.²⁶³ The latter—whether employees, financial creditors, consumers, or other stakeholders—continue to be entitled to their full extra-corporate legal claim. Neither one of the two claims, however, is a matter of fiduciary duty. For some reason, scholarly discourse on corporate law in the vicinity of insolvency often turns to an aggregate-like conception,²⁶⁴ overlooking the many positive law sources that stress the corporation's entity nature.²⁶⁵

This understanding is shared by the leading Delaware cases in the insolvency context. Because stakeholders have a direct legal claim against the corporation—and no such claim toward directors or officers—it is appropriate that Delaware's foundational case gives stakeholders standing to vindicate the entity's rights, against *its* fiduciaries, by filing a *derivative* action (a power that, outside of insolvency, is reserved to shareholders).²⁶⁶ Although some scholars view this decision as signaling

263. Due to the concept of limited liability (which is closely related to corporate personhood), shareholders are also not required to pay stakeholders for what the latter cannot recover from the corporation. When limited liability is unavailable—for example, in the case of general partnerships—the residual claimants (partners) might, in fact, hold shares (partnership interests) with *negative* economic value. See Raz, *supra* note 110, at 273 n.74.

264. See, e.g., Jared A. Ellias & Robert J. Stark, *Delaware Corporate Law and the "End of History" in Creditor Protection*, in FIDUCIARY OBLIGATIONS IN BUSINESS, *supra* note 111, at 207, 207–15 (“[D]irectors and officers will be held liable to shareholders . . . [W]hen insolvency sets in[,] . . . creditors replace shareholders as the primary economic stakeholders. . . . [S]ome scholars had always felt that fiduciary duty law ought to protect creditors . . .”). Clearly, this issue also has to do with the seemingly dualistic language employed in many Delaware cases, suggesting that fiduciary duties are owed “to the corporation and its shareholders,” e.g. *Gheewalla*, 930 A.2d at 99. Yet, a broader look at Delaware case law reveals that even this usage practically points to fiduciary duties being owed solely to the corporate entity. See, e.g., Raz, *supra* note 19, at 561. Considering that cases such as *Gheewalla* itself switch between the above-mentioned formulation and the correct one, see *Gheewalla*, 930 A.2d at 101 (“It is well settled that directors owe fiduciary duties to the corporation.”), 103 (“[D]irectors . . . have a fiduciary duty to exercise their business judgment in the best interest of the insolvent corporation.”), we might as well go with the more accurate language, which coheres with the rest of corporate law's building blocks and with its normative goals.

265. See *supra* notes 64–81 and accompanying text.

266. See *Gheewalla*, 930 A.2d at 101–03 (“[T]he creditors of an insolvent corporation have standing to maintain derivative claims against directors on behalf of the corporation for breaches of fiduciary duties. . . . [I]ndividual creditors of an insolvent corporation have no right to assert direct claims for breach of fiduciary duty against corporate directors. Creditors may nonetheless protect their interest by bringing derivative claims on behalf of the insolvent corporation”)

a turn against creditors in Delaware law,²⁶⁷ its holding is a simple application of bedrock corporate law principles on fiduciary duty and personhood. The real locus for reform is the extent to which creditor-initiated derivative actions should be successful, which is discussed shortly below.

The Delaware Court of Chancery has further made these points on various occasions. According to one well-known 1991 case,

[the optimal] result will not be reached by a director who thinks he owes duties directly to shareholders only. It will be reached by directors who are capable of conceiving of the corporation as a legal and economic entity. . . . [C]ircumstances may arise when the right (both the efficient and the fair) course to follow for the corporation may diverge from the choice that the stockholders (or the creditors, or the employees, or any single group interested in the corporation) would make if given the opportunity to act.²⁶⁸

In a 2004 case, involving an attempt by a creditor to plead direct claims against directors, the court similarly offered that

[c]laims [for mismanaging the firm] are classically derivative, in the sense that they involve an injury to the corporation as an entity and any harm to the stockholders and creditors is purely derivative of the direct financial harm to the corporation itself. The fact that the corporation has become insolvent does not turn such claims into direct creditor claims, it simply provides creditors with standing to assert those claims. At all times, claims of this kind belong

(emphases omitted)). This leads to an important question: why do shareholders sometimes have the power to pursue direct claims against fiduciaries—for example, in *Revlon* mode, see *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986)—while the more senior stakeholders are limited to derivative claims, even in the exceptional situation of insolvency (or *Gheewalla* mode)? The answer is grounded in the structure of the relevant legal relationships. As a constant fact, stakeholders' claims are toward the corporate entity. Even if fiduciaries' conduct has caused the entity to dishonor those claims, the litigation remains direct (between the stakeholder and the entity) and derivative (between the entity and its fiduciaries). In contrast, *Revlon* mode represents an "[inevitable] break-up of the company," *Revlon*, 506 A.2d at 182. In other scenarios, as well, shareholders might be harmed, but it will not be possible to sue the corporate entity. In those situations, it may be necessary to impose ad hoc fiduciary duties toward shareholders. See *Raz*, *supra* note 19, at 559–60. Even in such cases, the primacy of stakeholders' legal claims remains unaltered. See *infra* note 335. It can seem counter-intuitive that the more senior stakeholders might have to go through more procedural hurdles, in the form of derivative litigation; yet, this is fully consistent with the legal primacy norm, which immutably preserves stakeholders' direct claims against their original counterparty, a privilege that residual claimants do not have.

267. See, e.g., *Ellias & Stark*, *supra* note 264, at 218–20.

268. *Credit Lyonnais Bank Nederland, N.V. v. Pathe Commc'ns Corp.*, C.A. No. 12150, 1991 Del. Ch. LEXIS 215, at *108 n.55 (Del. Ch. Dec. 30, 1991).

to the corporation itself because even if the improper acts occur when the firm is insolvent, they operate to injure the firm in the first instance by reducing its value, injuring creditors only indirectly by diminishing the value of the firm and therefore the assets from which the creditors may satisfy their claims. . . . [T]he fact of insolvency does not change the primary object of the director's duties, which is the firm itself. The firm's insolvency simply makes the creditors the principal constituency injured by any fiduciary breaches that diminish the firm's value and logically gives them standing to pursue these claims to rectify that injury.²⁶⁹

After clarifying who are the actors on the playing field (the corporate entity and its fiduciaries; separately, the entity and its stakeholders), what changes in the insolvency context (the corporation's purpose) and what does not (the beneficiary of fiduciary duties), and how those duties can be enforced (in a derivative, not direct, action), the next question is: under what circumstances a lawsuit of this kind ought to succeed? In other words, *when* does a corporation's purpose shift from entrepreneurial to custodial, in a manner that might justify imposing judicial liability on its fiduciaries, if they failed to respond to this change? Other jurisdictions, including the United Kingdom and Australia, have adopted detailed statutory provisions mandating the above-described shift in corporate purpose.²⁷⁰ Where no such statutory command exists, as in Delaware, it makes sense to go back to first principles.

A derivative action against a corporation's fiduciaries—in the insolvency context or otherwise—should succeed if the fiduciaries failed to act loyally, that is, in a manner that advances the corporation's purpose.²⁷¹ Because that purpose is the *lawful* pursuit of profit—with the “lawful” element always preceding the “profit” one²⁷²—and because insolvency means the corporation will not be able to meet all legal obligations when due, it cannot possibly be within directors' business judgment to knowingly push the corporation either into insolvency, or deeper down an existing insolvency. In many insolvency cases, that is not what directors are doing, and the business judgment rule should continue to apply. Corporate law does not say that a corporation may never become insolvent, or that in every such case, creditors can sue someone apart from the entity itself. It does say, however, that directors must make a good faith *attempt* to advance the corporation's purpose,²⁷³ and that is not the

269. *Prod. Res. Grp., L.L.C. v. NCT Grp., Inc.*, 863 A.2d 772, 776–92 (Del. Ch. 2004) (footnote omitted).

270. See Licht, *supra* note 256, at 1761–63 & n.112.

271. See *supra* Section II.A.

272. See *supra* Section I.C.

273. See *supra* Section II.A.

case when they choose to close their eyes in the face of known insolvency.

Accordingly, the remainder of this Section calls for a moderate expansion of Delaware law, such that the shift in the corporation's purpose—and, derivatively, in the behavior expected of its fiduciaries—could, under some conditions, occur in the vicinity of insolvency, rather than only after the corporation has become fully insolvent; and would prohibit knowingly deepening the corporation's insolvency.

The proposed test is this: in the vicinity of insolvency, or actual insolvency, the business judgment rule should apply to a fiduciary's conduct, unless the fiduciary knew, or should have known, that the conduct is more likely than not to harm the entity's ability to meet its legal obligations to stakeholders (whether creditors, employees, consumers, or others). This test cautiously modifies two of the six prongs of existing doctrine recounted in the *Quadrant II* decision.²⁷⁴ It adopts the same balance between director shielding and stakeholders' rights that is already in place with well-established doctrines such as *Stone*,²⁷⁵ *Caremark*,²⁷⁶ and the mandatory limits on dividends on buybacks.²⁷⁷ In this balance, a knowing act (or omission) that causes the corporation to violate other people's positive law rights tips the scales in favor of substantive judicial review. An entity navigating in the vicinity of insolvency can make a wide range of business choices, but a choice directors *know* will cause it to become insolvent is not a permissible business decision.²⁷⁸ Similarly, if the corporation is already insolvent, there is simply no good reason to allow its fiduciaries to knowingly deepen this situation, injuring even more stakeholders.²⁷⁹

Like broader corporate fiduciary law, this test focuses on fiduciaries' subjective state of mind. Like other parts of the legal primacy norm, it

274. *Quadrant Structured Prods. Co. v. Vertin*, 115 A.3d 535 (Del. Ch. 2015). The two prongs are: "There is no legally recognized 'zone of insolvency' with implications for fiduciary duty claims. The only transition point that affects fiduciary duty analysis is insolvency itself," *id.* at 546 (footnote omitted), and "Delaware does not recognize the theory of 'deepening insolvency,'" *id.* at 547.

275. *Stone v. Ritter*, 911 A.2d 362 (Del. 2006). For discussion, see *supra* Section II.A.

276. *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959 (Del. Ch. 1996). For discussion, see *supra* Section II.B.

277. See *supra* Section II.C.

278. See, e.g., Rock & Wachter, *supra* note 38, at 1674 ("[T]he duty to act lawfully [is] an area that traditionally has fallen outside of the business judgment rule.").

279. Existing case law might support this statement. While "[d]irectors cannot be held liable for continuing to operate an insolvent entity in the good faith belief that they may achieve profitability," *Quadrant II*, 115 A.3d at 547, knowingly causing the entity to breach more of its legal obligations does not satisfy the requirement of good faith, see *supra* Section II.A. The test proposed here can be seen as incorporating *Stone* into the insolvency context—which should not be a surprising move, since in that situation, paying regard to the corporation's legal liabilities is an even bigger concern than it is with a solvent entity.

recognizes that not every claim toward the entity can be translated into a claim against its fiduciaries,²⁸⁰ while at the same time placing a meaningful duty on the latter to prevent a knowing descent into insolvency. It can accommodate a broad range of financial situations, rather than limiting itself to a single trigger for when the normative shift occurs.²⁸¹ It also departs from the argument made in some Delaware cases, which points to various non-corporate law devices that are meant to protect creditors, such as “strong covenants, liens on assets, . . . other negotiated contractual protections[, t]he implied covenant of good faith and fair dealing[,] . . . [and] the law of fraudulent conveyance.”²⁸² Most of the time, those protections are valuable, but when the corporation approaches insolvency, this means—by definition—that non-corporate legal rights are at risk of being frustrated. The corporate doctrine discussed in this Section is meant to address exceptional situations, where fiduciaries are causing such extra-corporate devices to become ineffective.

In summary, the shift in corporate purpose in the vicinity of insolvency (and, by logical extension, in actual insolvency) is an important part of corporate law’s commitment to stakeholders’ legal rights. As one article recently argued, despite the historical divide between these two fields, corporate and bankruptcy law work toward the same goal: protecting stakeholders’ claims, even during economic calamity.²⁸³ In an equal formulation, as proposed in this Article, corporate law—both in and outside of insolvency—operates to maximize the corporation’s legal compliance.

E. *The Seniority of Preferred Shareholders and Trust Shareholders*

This Section discusses two unique phenomena—preferred shares, and shares issued by trustee corporations—and frames the doctrines surrounding them as an aspect of the legal primacy norm. Doing so helps resolve a long-standing puzzle. The majority of non-corporate legal frameworks—whose violation can, additionally, lead to sanction under the internal corporate doctrines surveyed in this Article—are *clearly*

280. See *supra* note 205.

281. A recent U.K. decision contemplates four possible triggers: “First, it may be when the company is actually insolvent, either on a cash-flow or balance sheet basis. . . . Second, it may arise when the company is on the verge of insolvency or nearing or approaching insolvency. . . . Third, it may arise when the company is or is likely to become insolvent. . . . Fourth, it might be . . . where there is a real, as opposed to a remote, risk of insolvency.” *BTI 2014 LLC v. Sequana S.A.* [2019] EWCA (Civ) 112 [213] (Eng.), *aff’d*, [2022] UKSC 25. The test proposed here fits both the first and any of the latter three options, pursuant to lawmakers’ discretion.

282. *Prod. Res. Grp., L.L.C. v. NCT Grp., Inc.*, 863 A.2d 772, 790 (Del. Ch. 2004), *quoted in* *N. Am. Cath. Educ. Programming Found., Inc. v. Gheewalla*, 930 A.2d 92, 100 (Del. 2007).

283. See Odelia Minnes & Dov Solomon, *Game of Thrones: Corporate Law and Bankruptcy Law in the Arena of Directors’ Liability*, 27 COLUM. J. EUR. L. 1, 17–27 (2021).

external to corporate law: tort, environmental, or criminal law generate no confusion as to their non-corporate character.

Two specific areas—contract and trust law—do, however, occasionally get embroiled in such confusion. That occurs when the contractual or trust claims happen to be called “shares”; those shares sometimes happen to be a mix of *both* contract or trust, *and* corporate law residual claims;²⁸⁴ the stakeholders who own them happen to be called “preferred shareholders,” or the shareholders of an investment company; and the duty-holder happens to be a corporate entity. In this situation, much of the scholarship has tended to treat those stakeholders as if they really are shareholders, and discuss the legal and economic issues pertaining to them from an intra-corporate perspective of fiduciary duty.²⁸⁵

Because substance is more important than form—in other words, it is impossible to turn something into a matter of corporate law simply by calling it a “share”—this Section shows that a different approach is warranted. In fact, preferred shareholders have rights as contract parties, and investment company shareholders have rights as trust beneficiaries. Accordingly, under the legal primacy norm, their claims precede those of actual (residual) shareholders. When fiduciaries make decisions affecting preferred or trust shareholders, they must consider those stakeholders’ positive law claims. Specifically, the fiduciaries are required to cause the stakeholders’ counterparty—the corporate entity—to fully meet those obligations. If a preferred or trust share is a package of both corporate and non-corporate claims, the treatment should be split: the non-corporate rights must first be honored, then those claimants should be treated on par with other shareholders.

This framing is not theoretical, but represents precisely what Delaware law says. First, regarding preferred shares, a good starting point may be the 2013 debate between Professors William Bratton and Michael Wachter, on one side, and then-Chancellor Leo Strine, on the other. As Professors Bratton and Wachter wrote, “[s]tockholders are corporate, lenders are contractual, and a well-understood wall separates their legal treatments. Preferred stock straddles the wall. . . . Preferred stock sits on a fault line between two great private law paradigms, corporate law and contract law.”²⁸⁶ They then identified various practical problems which, in their view, justify endowing preferred shareholders with additional

284. See *supra* text accompanying notes 108–25 (discussing the nature of shareholders as residual claimants).

285. See, e.g., Sarath Sanga & Eric Talley, *Don’t Go Chasing Waterfalls: Fiduciary Duties in Venture Capital Backed Startups* (Eur. Corp. Governance Inst., Working Paper No. 634, 2022), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3721814 [<https://perma.cc/DCD9-ZZAY>].

286. William W. Bratton & Michael L. Wachter, *A Theory of Preferred Stock*, 161 U. PA. L. REV. 1815, 1819–20 (2013).

corporate law protections.²⁸⁷ In response, Strine offered a simple argument: “To the extent the preferred get a contract right, they are preferred. To the extent they do not, they are subject to the same risks as other stockholders and entitled to no extra value or rights.”²⁸⁸

Strine’s position is not surprising, because he and other judges have also expressed it as part of controlling Delaware precedent. Contrary to Bratton and Wachter’s concerns, these decisions can be read as clarifying that the split treatment—hewing to both contract and corporate law, each in its respective domain—places preferred shareholders in a *superior* position, compared to what they would have as fully intra-corporate, residual claimants. Similar to other aspects of the legal primacy norm, this mode of analysis protects the former without detracting from the rights of the latter.

For example, in a 2010 case, then–Vice Chancellor Strine wrote that “it is the duty of directors to pursue the best interests of the corporation and its common stockholders, *if that can be done faithfully with the contractual promises* owed to the preferred.”²⁸⁹ Similarly, in 1997, Chancellor Allen stated that “[t]he special protections offered to the preferred are contractual in nature. *The corporation is, of course, required to respect those legal rights.* . . . The facts of this case . . . do not involve any violation . . . of any special right or privilege of the Series A preferred stock, nor of [their] residual right[s].”²⁹⁰

As with the other doctrines discussed in this Part, the analytical starting point for Delaware judges, in preferred share cases, is non-corporate law. The corporation must meet its obligations to stakeholders (here, contractual duties to preferred shareholders), whether a liquidation preference (as in the two above-quoted cases) or any other duty flowing from the instrument that created the preferred series. If the corporation fails to do so, preferred shareholders can bring suit, similar to other stakeholders. Uniquely, that litigation will proceed in a corporate law court (since preferred shares are mentioned in the Delaware General Corporation Law),²⁹¹ but as a rule, it will not be based on a corporate law cause of action—asking whether the directors have met their duties *to* the

287. *See id. passim.*

288. Leo E. Strine, Jr., Response, *Poor Pitiful or Potently Powerful Preferred?*, 161 U. PA. L. REV. 2025, 2040 (2013).

289. LC Cap. Master Fund, Ltd. v. James, 990 A.2d 435, 452 (Del. Ch. 2010) (emphasis added). As this Article explains, causing the corporation to meet all of its legal obligations, including contractual ones, is already embedded in the concept of “pursuing the best interests of the corporation.” *See supra* notes 165–68 and accompanying text.

290. Equity-Linked Invs., L.P. v. Adams, 705 A.2d 1040, 1042 (Del. Ch. 1997) (citation omitted; emphasis added).

291. *See* DEL. CODE ANN. tit. 8, §§ 102(a)(4), 151 (2022).

entity—but rather on the preferred shareholders’ senior, contractual claims *against* the entity.²⁹²

This does not mean, however, that the corporation has a legal duty to better its preferred shareholders’ position, beyond the rights that they actually have. This equally applies to other stakeholders, and generally to relations among people in society.²⁹³ If certain events—such as, typically, the decision whether to go into liquidation while the entity still has cash available for distribution to the preferred²⁹⁴—are contingent upon a choice made by the board of directors, the board has a duty to make a good faith decision, one which advances *the corporation’s* purpose.²⁹⁵ That decision might be to continue operating (and possibly losing the remaining funds), but this open-ended uncertainty, fortified by the business judgment rule, is precisely the strength of corporate law.²⁹⁶

At the same time, as Bratton, Wachter, and later scholars²⁹⁷ have pointed out, there are real problems with the design and enforcement of preferred shareholders’ rights. Power and information asymmetries, and sometimes plain refusal to honor the contractual claims of preferred shareholders (exemplified by the deliberate breach of consent rights),²⁹⁸ are serious impediments. These are specific instances of the general problems—non-optimal law, the compliance gap, and the enforcement gap—identified earlier.²⁹⁹ The focal point for analyzing, and finding solutions to, these problems is the non-corporate legal framework that generates the preferred shareholders’ rights. In some cases, a problem

292. See, e.g., *Blue Chip Cap. Fund v. Tubergen*, 906 A.2d 827, 834 (Del. Ch. 2006) (“[Plaintiff’s] claimed right as a preferred stockholder to a larger distribution of the proceeds arises from contractual rights and obligations under the certificate of incorporation—a binding contract between the company and its preferred stockholders. . . . Therefore, the claim is for breach of contract and for breach of the implied covenant of good faith and fair dealing Accordingly, the court concludes that contract, and not fiduciary, principles should govern the analysis and dismisses the fiduciary duty claims against the directors.”). Note that the court’s discussion of the certificate of incorporation as a contract applies only to the preferred shareholders; it does not detract from the fact that the corporation’s certificate is *not* a contract, in the more general setting, where it governs the rights of the corporate entity and its residual claimants (possibly including its preferred shareholders, to the extent they do have a corporate law claim), see *Raz*, *supra* note 26, at 226, 261–83. Rather, it simply means that different Hohfeldian relationships can flow from the same document or action, and in such cases, a court should make separate legal analyses, according to the content of each party’s specific sets of rights and duties.

293. See *supra* Section I.A.

294. See, e.g., *LC Capital*, 990 A.2d at 438; *Equity-Linked Investors*, 705 A.2d at 1041.

295. See *supra* Section II.A.

296. See *supra* text accompanying notes 82–102.

297. See, e.g., Karen A. Chesley, *Not Without Consent: Protecting Consent Rights Against Deliberate Breach*, 80 MD. L. REV. 95 (2020); sources cited *id.* at 108 n.70 (criticizing recent Delaware case law in the area of preferred shares); Pollman, *supra* note 81.

298. See Chesley, *supra* note 297.

299. See *supra* text accompanying notes 52–60.

internal to corporate law—such as residual shareholders receiving an unlawful distribution³⁰⁰—might also impair those rights; but, as this Article demonstrates, corporate law’s legal primacy norm already offers multiple, powerful remedies in that situation, which courts should use liberally.

The case of trust shareholders—people who hold a trust law claim toward a trustee corporation, when that claim is packaged as a “share,” a “unit,” or a similar moniker—is conceptually similar, although not identical, to that of preferred shareholders. The first issue pertains to the distinct nature of trust law: a trustee is bound by a set of unique duties to the beneficiaries; in addition to the general fiduciary duty of loyalty, the trustee is required to administer the trust funds in a prudent manner, often while pursuing a pre-set investment plan—and, on top of all, while owing an *enforceable* duty of care to the beneficiaries, not foreclosed by a business judgment rule.³⁰¹ This generally makes the trustee’s actions more limited and custodial than those of a corporation (meaning one that does not serve as a trustee, or outside the scope of its trust duties).³⁰²

The second key issue is only slightly more prosaic, and concerns the scope of investments managed by trustee corporations: at the end of 2021, U.S.-based, regulated open-end funds held about \$34.2 trillion in assets.³⁰³ Existing literature focuses on investment fund entities as subjects of federal regulation.³⁰⁴ They are also a frequent feature of corporate law scholarship, due to their role as activist (or less activist)³⁰⁵ shareholders.

300. See *supra* Section II.C.

301. See, e.g., Robert H. Sitkoff, *Fiduciary Principles in Trust Law*, in THE OXFORD HANDBOOK OF FIDUCIARY LAW 41, 41 (Evan J. Criddle, Paul B. Miller & Robert H. Sitkoff eds., 2019) (“[T]he trust law duty of care . . . is not softened by a business judgment rule.”).

302. See Licht, *supra* note 256, at 1745–49. For additional discussion of the structural and functional difference between trust law and corporate law, see, for example, Raz, *supra* note 19, at 548 n.129; Rock & Wachter, *supra* note 197.

303. See INV. CO. INST., 2022 INVESTMENT COMPANY FACT BOOK: A REVIEW OF TRENDS AND ACTIVITIES IN THE INVESTMENT COMPANY INDUSTRY 6 (2022), https://www.icifactbook.org/pdf/2022_factbook.pdf [<https://perma.cc/79DN-9726>]. This number continues to grow steadily, as does the variety of investment funds. See, e.g., John Morley, *The Separation of Funds and Managers: A Theory of Investment Fund Structure and Regulation*, 123 YALE L.J. 1228, 1231 & n.1 (2014) (stating that “[i]nvestment funds control a vast amount of wealth. By some estimates, the various types of funds—including mutual funds, hedge funds, private equity funds, venture capital funds, exchange-traded funds, and closed-end funds—collectively hold about \$18 trillion in the United States”; also providing a brief taxonomy of various types of investment funds).

304. See, e.g., TAMAR FRANKEL & KENNETH E. BURDON, INVESTMENT MANAGEMENT REGULATION (5th ed. 2015).

305. See, e.g., Lucian Bebchuk & Scott Hirst, *Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy*, 119 COLUM. L. REV. 2029 (2019) (arguing that index fund managers should play a greater role in corporate governance).

The argument made here, coming from a different angle of corporate law, is that the trustee corporation's directors (or other fiduciaries) have an enforceable duty, owed to the entity,³⁰⁶ to cause it to fully comply with its beneficiaries' rights under trust law.³⁰⁷ In turn, the beneficiaries (or shareholders) have claims toward the entity itself, including equitable rights relating to the trust property.³⁰⁸ Similar to the preferred shareholders discussed above, trust shareholders might *also* possess a residual claim, governed by corporate law. Under the legal primacy norm, the former claim is always senior to the latter. Any analogy from corporate law, or the rights of residual shareholders, must take place within this predicate.

306. See Raz, *supra* note 19, at 574 n.273. To state this in greater practical detail, when a lawsuit (most commonly, a derivative action, filed by trust shareholders) is brought against a trustee corporation's *own* fiduciaries, the court should less readily apply the business judgment rule. That is because the trustee corporation differs from a "regular," non-trustee corporation, in that the vast majority of its daily activities relate to meeting its duties under trust law—and *not* to taking business risks under corporate law (linked to its open-endedness principle, see *supra* text accompanying notes 82–102). In many cases, a trustee corporation can engage in business ventures outside of trust law, but only if those do not interfere, in any way, with its activities as a trustee. Therefore, when a trustee corporation's fiduciaries mismanage the entity, they are more likely to be violating the legal primacy norm (by causing the entity to breach its trust obligations), as opposed to merely making a bad business decision protected by the business judgment rule. Importantly, this structure of duties also applies when some of the trustee corporation's fiduciaries are themselves corporations. That is the standard case for mutual funds, where the trustee entity (known as an "investment company" under the Investment Company Act of 1940, 15 U.S.C. §§ 80a-1 to -64) is controlled by a different corporation (the "sponsor" or "investment advisor"), which runs many different such entities. Here, once again, the advisor entity owes fiduciary duties (under general and statutory fiduciary law) to the trustee entity; and the advisor entity's fiduciaries, which at this stage are often humans, owe duties to that entity (under corporate law, including the legal primacy norm and the requirement to cause the advisor entity to meet its fiduciary law obligations). The duties owed by the advisor's fiduciaries may be enforced through what is effectively a "double derivative action," filed by the trustee entity's trust shareholders. See Donald C. Langevoort, *Private Litigation to Enforce Fiduciary Duties in Mutual Funds: Derivative Suits, Disinterested Directors and the Ideology of Investor Sovereignty*, 83 WASH. U. L.Q. 1017, 1019–30 (2005) (discussing this structure in detail and providing many examples of judicial cases). Although seemingly complex, this chain of fiduciary duties actually provides an excellent illustration of Professor Henry Smith's view of equity as the legal response to "intense interactions[, which] can lead to unforeseen . . . results," Smith, *supra* note 42, at 1056.

307. This statement holds true for any kind of trustee corporation—not just investment fund entities (although they are the most salient example), but also traditional "trust companies," or any other corporation that becomes a trustee. See, e.g., WILMINGTON TR., <https://www.wilmingtontrust.com> [<https://perma.cc/MZ9N-JCTZ>] (offering services in the field of trust law, but outside the domain of investment funds, such as "Trust & Estate Services" and "Institutional Custody & Administrative Services").

308. See Raz, *supra* note 19, at 574 n.273.

This form of analysis also sheds new light on the questions posed in important articles by Professors Eric Roiter³⁰⁹ and Steven Schwarcz.³¹⁰ These authors correctly highlight the unique characteristics of investment fund entities, compared to other corporations.³¹¹ Yet, they do so more on a concept-by-concept or doctrine-by-doctrine basis.³¹² The framework suggested in this Article clarifies that the key word in Professor Roiter’s argument is “compliance.”³¹³ The investment fund manager, as a fiduciary for the trustee entity, is bound primarily by the need to assure the entity’s compliance with its trust law obligations. The difference between those obligations and what a “regular” corporation owes to residual shareholders—a result of the *legal* distinction between trust and corporate law³¹⁴—is the fundamental reason for “commercial trusts and corporations [being] mirror-image entities that respond to different investor needs.”³¹⁵ Because those investor needs manifest in the form of different legal rights toward the entity, the legal primacy norm helps assure that trust assets—today, in the tens of trillions of dollars—are beneficially invested and managed.

F. *The Judicial Dissolution of Law-Breaking Corporations*

Corporations occasionally reach the end of their lives. This often happens in the form of a merger, where one corporate entity ceases to exist, while its rights and obligations pass, as a whole, to another entity.³¹⁶ Corporate existence can end through an additional process: dissolution

309. Eric D. Roiter, *Disentangling Mutual Fund Governance from Corporate Governance*, 6 HARV. BUS. L. REV. 1 (2016).

310. Steven L. Schwarcz, *Commercial Trusts as Business Organizations: Unraveling the Mystery*, 58 BUS. LAW. 559 (2003).

311. See Roiter, *supra* note 309, at 81 (“Mutual funds differ fundamentally from ordinary corporations . . .”); Schwarcz, *supra* note 310, at 560 n.9 (arguing that the differences between trusts and other corporations “are indeed quite fundamental”).

312. See, e.g., Roiter, *supra* note 309, at 81 (discussing “the unique right of mutual fund investors to withdraw their capital by exercising a right of redemption”); *id.* at 81–82 (“Business judgment decision-making within a mutual fund lies primarily with its investment adviser, not its directors, because the adviser makes the investment decisions on behalf of the fund’s customers: the fund’s investors. The focus of SEC rulemaking, therefore, ought not to be to expand the business judgment decision-making role of fund directors, but rather to strengthen their effectiveness as monitors of compliance by the fund adviser, who has legal and fiduciary duties.”).

313. *Id.* at 82.

314. See *supra* notes 301–02 and accompanying text.

315. Schwarcz, *supra* note 310, at 585.

316. See, e.g., DEL. CODE ANN. tit. 8, § 259(a) (2022) (“When any merger . . . shall have become effective . . . , the separate existence of all . . . constituent corporations except the one into which the other or others of such constituent corporations have been merged, . . . shall cease and the constituent corporations shall . . . be merged into 1 of such corporations, . . . possessing all the rights . . . , and being subject to all the . . . duties of each of such corporations so merged . . .”).

(also known as liquidation). Dissolution may occur in different contexts, such as a voluntary dissolution,³¹⁷ or a court-ordered dissolution, often following bankruptcy.³¹⁸ This Section concludes the list of legal primacy doctrines discussed in this Article, by focusing on a specific form of judicial dissolution, not necessarily due to bankruptcy, but premised on the liquidated corporation's sustained failure to comply with the law. This procedure is also widely known as the "corporate death penalty."³¹⁹

In Delaware, such dissolution is authorized by Section 284 of the Delaware General Corporation Law, which provides that "[u]pon motion by the Attorney General, the Court of Chancery shall have jurisdiction to revoke or forfeit the charter of any corporation for abuse, misuse or nonuse of its corporate powers, privileges or franchises."³²⁰ While the statutory text does not explicitly say that violation of non-corporate law might amount to such "abuse" or "misuse," Delaware case law has stated that, for example, "[c]ontinued serious criminal violations by corporate agents in the course of the discharge of their duties could very well constitute the misuse of a charter."³²¹

Although recent case law is not replete with Section 284 dissolution proceedings, two points should be made here. First, judicial dissolution appears to be the most drastic measure courts can wield against corporations that refuse to operate within the bounds of law. Accordingly, this measure should be used in a relatively sparse manner, and mostly in regard to truly incorrigible corporations—for example, those established, from the outset, to carry out unlawful activities.

Second, as an analytical matter, dissolution is unique among the legal primacy devices discussed in this Part. The other doctrines focus on translating non-corporate law violations (or an increased likelihood thereof) into legal sanctions against the corporation's fiduciaries (as with fiduciary good faith³²² and *Caremark*³²³), or its shareholders (as with the requirement to repay unlawful dividends).³²⁴ The remedy in such cases—which are mostly handled as derivative actions—goes to *the corporation*. Judicial dissolution, in contrast, distinctly trains its sights on the corporate entity itself.

Although directors and shareholders might *also* be exposed to corporate liability in such cases, the phasing out of the corporation

317. See, e.g., *id.* § 275.

318. See, e.g., *id.* §§ 291–303.

319. See, e.g., George S. Geis, *Shareholder Clawbacks for Corporate Misdeeds*, 26 STAN. J.L. BUS. & FIN. 35, 41 n.14 (2021) ("One extreme alternative is the 'corporate death penalty' where a firm might be required to dissolve itself and cease business operations.").

320. Tit. 8, § 284(a).

321. *Craven v. Fifth Ward Republican Club*, 146 A.2d 400, 402 (Del. Ch. 1958).

322. See *supra* Section II.A.

323. See *supra* Section II.B.

324. See *supra* Section II.C.

eliminates *all* corporate relationships—including with uninvolved shareholders, and those stakeholders (if any) who were not harmed by the corporation’s disobedience. The fact that corporate law nonetheless provides this option is a testimony to its broad commitment to rule of law principles, and its unequivocal position that compliance with external law cannot be a matter of cost-benefit analysis.

III. LEGAL PRIMACY AS AN ALTERNATIVE TO EXISTING CONCEPTIONS OF CORPORATE LAW

A. *Legal Primacy Differs from Shareholder Primacy*

At the beginning of this Article, Milton Friedman is quoted arguing that businesses should pursue profit “while conforming to the basic rules of the society, [including] those embodied in law.”³²⁵ Given that such a leading proponent of shareholder primacy paid attention to this caveat, one might naturally ask: what is the difference between legal primacy and shareholder primacy?

The answer, provided in this Section, has two main parts. First, although an early advocate such as Friedman was cautious to note the legal constraints binding every corporation, this distinction has eroded in later shareholderist writing. Some scholarship today even views non-compliance as something akin to a business decision, worthy of protection under the business judgment rule.³²⁶ Second, the legal primacy norm, as presented in this Article, connects with broader issues in corporate theory, and challenges some well-entrenched pillars of the shareholderist conception—for instance, the belief that a corporation is a “nexus of contracts,” the minimization of the corporation’s separate personhood, and the closely related view that fiduciary duties run directly (and only) to shareholders.

To begin with, as a purely descriptive matter, the idea of “shareholder primacy” has little basis in fact. The exact opposite is true: corporate law has always insisted on a strong form of shareholder *subordination*. In both legal and economic terms, shareholders rank *last* in the order of priority for receiving the corporation’s assets.³²⁷ They also cannot validly interfere with other, higher-ranked stakeholders’ claims toward the corporation.³²⁸ The privileges that shareholders do have—such as the

325. Friedman, *supra* note 1.

326. See *infra* notes 337–41 and accompanying text.

327. This is demonstrated by the legal, accounting, and financial concept of “shareholders’ equity” or “net worth,” which is the amount of the corporation’s assets *minus* all of its obligations to non-shareholders. By definition, shareholders have a legal and economic claim only in regard to this amount. See, e.g., Raz, *supra* note 110, at 273, 274 n.77, 311; *supra* text accompanying notes 235–43.

328. See *supra* note 21 and accompanying text.

right to vote for directors, which has become highly salient with the rise of shareholder activism³²⁹—are themselves products of law, and are limited to the sphere of lawful action by both the voting shareholders and the elected directors.³³⁰ Even if shareholders, or any other corporate law actor, *wanted* to pursue profit without regard to the legal constraints binding the corporation, corporate law itself precludes that possibility, in an unwaivable manner.

This holds true either when the corporation is solvent (for example, with the mandatory limits on dividends and buybacks)³³¹ or insolvent. In the latter case, corporate law modifies the corporation’s purpose (and the behavior thus expected of its fiduciaries), from an entrepreneurial to a custodial one, meant to increase stakeholders’ chances of receiving their due.³³² External areas—namely, bankruptcy law—also ensure “the precedence to be accorded creditors over stockholders.”³³³ Under these circumstances, it is truly unclear what “primacy” shareholders possess.

If shareholder primacy means that fiduciaries are required to act primarily for the benefit of shareholders, this is also not an accurate portrayal of corporate law. Outside of narrow exceptions, such as *Revlon* mode,³³⁴ fiduciary obligations run solely to the corporate entity—not to shareholders *or* stakeholders.³³⁵ In turn, as this Article explains in detail,

329. See, e.g., Raz, *supra* note 19, at 567 (“Shareholder activism is the most important phenomenon in U.S. corporate law over the last two decades.”).

330. See, e.g., *In re Nine W. LBO Sec. Litig.*, 505 F. Supp. 3d 292 (S.D.N.Y. 2020) (partly denying motion to dismiss a fiduciary duty complaint against former directors of a corporation, for actions that were taken in the interest of a private equity investor, and which caused the corporation to become insolvent).

331. See *supra* Section II.C.

332. See *supra* Section II.D.

333. Case v. L.A. Lumber Prods. Co., 308 U.S. 106, 115–16 (1939).

334. See *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 182 (Del. 1986) (“[Once] the company was for sale[, t]he duty of the board had . . . 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.”).

335. See, e.g., *Paramount Commc’ns, Inc. v. Time Inc.*, 571 A.2d 1140, 1150 (Del. 1989) (“[D]irectors, generally, are obliged to charter a course for a corporation which is in its best interest [A]bsent a limited set of circumstances as defined under *Revlon*, a board of directors . . . is not under any *per se* duty to maximize shareholder value in the short term”); *N. Am. Cath. Educ. Programming Found., Inc. v. Gheewalla*, 930 A.2d 92, 101–03 (Del. 2007) (“It is well settled that directors owe fiduciary duties to the corporation. . . . Recognizing that directors of an insolvent corporation owe direct fiduciary duties to creditors, would create uncertainty for directors who have a fiduciary duty to exercise their business judgment in the best interest of the insolvent corporation.”); see also *Lacey v. Mota-Velasco*, C.A. No. 2019-0312-SG, 2021 Del. Ch. LEXIS 25, at *17–18 (Del. Ch. Feb. 11, 2021) (“It is fundamental that directors are not subject to a contract simply because it binds the corporation”). Note that even *Revlon* mode does not modify the legal primacy norm. Rather, it is simply a situation where the corporation’s legal duties to its stakeholders are not being implicated or challenged. This point has been stated as early as

the fiduciary's core duty—promoting the corporation's purpose—requires, prior to the pursuit of profit, causing the corporation to act lawfully. Shareholders' legal protections are grounded not in a concept of “primacy,” but in their equitable rights under corporate share law.³³⁶ Put simply, neither stakeholders nor shareholders have legal claims against the corporation's fiduciaries; both groups have claims toward the corporation itself; and the claims of stakeholders always come first.

Proponents of shareholder primacy, however, occasionally challenge this understanding. For example, in his 2022 article, Professor Stephen Bainbridge argues that “*Caremark* [is] a non-trivial intrusion on the board's obligation to maximize shareholder wealth. . . . In addition to being inconsistent with the shareholder wealth maximization norm, . . . *Caremark* is inconsistent with the board centric thrust of Delaware law.”³³⁷

To start with the second part of Bainbridge's claim, the business judgment rule provides extremely broad protection to corporate directors, but it does not provide infinite protection. In fact, “the rule imposes some conditions (including loyal and informed fiduciary action), comporting with the rest of corporate law's structure. Sometimes, those requirements are *not* met.”³³⁸ The legal primacy norm—of which *Caremark* is an important manifestation—does not impinge upon directors' freedom to make business decisions; rather, it conveys that breaking the law is not a business decision at all.³³⁹

This leads to the first prong of Bainbridge's statement. If the idea of “shareholder wealth maximization” existed in empty space, it might have been possible to claim that *Caremark* “intrudes” on that activity. In

the *Revlon* decision itself: “Here, the rights of the noteholders were fixed by agreement, and there is nothing of substance to suggest that any of those terms were violated.” *Revlon*, 506 A.2d at 182. The law is clear that the corporation must meet all of its legal obligations, and this requirement applies with equal force before, during, and after a merger or change of control transaction.

336. See *supra* notes 108–25 and accompanying text; Raz, *supra* note 19, at 539 (“[Shareholders] have an equitable, more-than-contractual claim toward the corporation, and are entitled to its profits when it either decides to distribute them, or dissolves. That claim, however, does not result in anything that can be called ‘shareholder primacy.’ It exists within a framework—corporate law—that promotes the corporation's pursuit of its own purpose.” (footnote omitted)).

337. Stephen M. Bainbridge, *Don't Compound the Caremark Mistake by Extending It to ESG Oversight*, 77 BUS. LAW. 651, 674 (2022).

338. Raz, *supra* note 26, at 240 n.92.

339. See, e.g., Rock & Wachter, *supra* note 38, at 1674 (“[T]he duty to act lawfully [is] an area that traditionally has fallen outside of the business judgment rule. Because of public policy imperatives, obeying the law has traditionally been considered a boundary condition within which firms maximize profits, but not, itself, subject to that calculus.”); *supra* Sections I.C, II.A. In *Caremark* situations, although directors themselves are not directly causing the breach of law, their failure to monitor the behavior of the entity—as a hierarchical organization—justifies the non-application of the business judgment rule. See *supra* Section II.B.

reality, however, we share a society with other people, each of whom enjoys certain legal rights. It would be paradoxical to argue that corporate law creates a norm of “shareholder primacy” that allows for violating the norms arising in *other* areas of law. Moreover, *Caremark* does not stand alone; it is part of a broader legal primacy concept, which encompasses at least five other doctrines.³⁴⁰ This confirms the fundamental role of legal obedience in the corporation’s *raison d’être*.³⁴¹

The shareholderist position, as expressed by Bainbridge, is also the result of broader trends in corporate theory over the last half-century. Here, a number of closely related ideas can be identified. As Professors Michael Jensen and William Meckling wrote in 1976, “the personalization of the firm . . . is seriously misleading. The firm is not an individual. It is a legal fiction which serves as a focus for a complex process . . . within a framework of contractual relations.”³⁴² In their well-known 1991 book, Judge Frank Easterbrook and Professor Daniel Fischel reiterated that “[t]he ‘personhood’ of a corporation is a matter of convenience rather than reality.”³⁴³ This connects with the view that the corporation is merely a “nexus of contracts”³⁴⁴ among other (presumably real) people, and that fiduciary duties—or, in economic terms, agency costs—subsist directly between “managers” and “shareholders.”³⁴⁵ Also related is the confusion, especially prevalent in the United States, between the concepts of “private law” and “contract.”³⁴⁶

As Professor David Gindis recently observed,³⁴⁷ however, Professors Jensen and Meckling’s denial of corporate personhood, and the related characterization of the corporation as a nexus of contracts, had little to do with methodical analysis of corporate law. Instead, it was the result of their opposition to the nascent corporate social responsibility movement of the 1970s.³⁴⁸ For a long time—and for many people, to this day—the

340. See *supra* Part II.

341. See, e.g., Strine et al., *supra* note 166, at 653 n.71 (“American corporate law embeds law compliance within the very mission of the corporation. Loyalty to the corporation’s obligation as a citizen to attempt in good faith to abide by the law is not incidental to a director’s duties, it is fundamental.”).

342. Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 311 (1976) (emphasis omitted).

343. EASTERBROOK & FISCHEL, *supra* note 125, at 12.

344. Eugene F. Fama & Michael C. Jensen, *Separation of Ownership and Control*, 26 J.L. & ECON. 301, 302 (1983) (“An organization is the nexus of contracts, written and unwritten, among owners of factors of production and customers.”).

345. Goshen & Squire, *supra* note 4, at 775.

346. See Raz, *supra* note 26, at 282–83; Raz, *supra* note 62, at 24–25.

347. Gindis, *supra* note 2.

348. See *id.* at 980–81 (“[Jensen and Meckling’s] definition makes sense once the socio-political context within which [their 1976 article] was written is taken into account. . . . [W]hen Jensen and Meckling got immersed in the public debate about corporate responsibility and

prevailing notion was that, if the corporation is an entity, it must also be a “social entity.”³⁴⁹ In contrast, if the corporation is a nexus of contracts, or the “property”³⁵⁰ of its shareholders, no demands of social responsibility can be leveled against it.³⁵¹

Yet, as this Article and earlier ones³⁵² demonstrate, this dichotomy is misguided. The corporation is a separate legal person, which today is recognized by leading law and economics scholars.³⁵³ At the same time, that person can lawfully pursue its own profit (and, to the extent its fiduciaries so choose, distribute some of that profit to shareholders).³⁵⁴ Jensen, Meckling, Easterbrook, Fischel, and Bainbridge would have been right to insist that the corporation is not legally bound by more than the sum of its legal obligations (as the following Section emphasizes), and that shareholders should continue to have meaningful, economically valuable, and legally enforceable rights. Elsewhere in his article, Bainbridge correctly raises these points.³⁵⁵ This has nothing to do with denying the corporation’s entity nature—or, as importantly, the fact that legal obligations do attach to corporations; that their fiduciaries are duty-bound to cause them to meet those obligations; and that their shareholders, as *residual* claimants, can only validly get what would remain after the corporation has fully done so.

B. *Legal Primacy Differs from Corporate Social Responsibility*

This Section examines the distinction between the legal primacy norm and the present-day understanding of corporate social responsibility (CSR). In doing so, this Section breaks CSR down to its conceptual and functional building blocks, in a manner not previously done in scholarship. It explains how CSR could be operationalized in practice—and why following this route, instead of relying on the superior combination of the legal primacy norm and non-corporate law, would be bad for stakeholders, corporations, and shareholders alike.

Prior to delving into that discussion, it is important to define what, exactly, CSR means. As Professor Elizabeth Pollman observed, “[t]he scope and contours of CSR are disputed and have shifted over time.”³⁵⁶

regulation in the late 1970s and early 1980s, their message that private corporations were unlikely to survive additional regulatory burdens followed from their definition of the firm.”).

349. Allen, *supra* note 7 *passim* (emphasis added).

350. *Id. passim*.

351. See, e.g., Jensen & Meckling, *supra* note 342, at 311 (“[T]he personalization of the firm implied by asking questions such as . . . ‘does the firm have a social responsibility’ is seriously misleading.”).

352. See Raz, *supra* note 19 *passim*; Raz, *supra* note 26, at 282–83.

353. See *supra* notes 14, 64, 81 and accompanying text.

354. See *supra* notes 112–16 and accompanying text.

355. See Bainbridge, *supra* note 337, at 668, 672.

356. Pollman, *supra* note 31, at 663.

Accordingly, Pollman offers three distinct categories of what CSR means to different people: “[R]eferences that ‘reduc[e] CSR to mere compliance with existing laws and market demands’; references that equate CSR with going ‘beyond compliance’; and references that are broadly stated without relation to law, that ‘CSR merely implies that businesses share responsibility for societal conditions.’”³⁵⁷

This Section criticizes CSR in a careful, narrowly tailored manner, as belonging only to the second category. The first category—requiring full and unwavering compliance with positive law—is not a form of extra-legal “social responsibility,” but a requirement inherently imposed on every person in society, including corporations.³⁵⁸ In fact, as this Article demonstrates, present-day corporate law *does* strongly incorporate this first meaning, through its legal primacy norm. If CSR simply means legal compliance, corporate law has always been one of the most socially responsible human endeavors. Yet, as discussed in this Section, many CSR advocates are unlikely to see that as a satisfactory interpretation.

There are several additional concepts that are *not* the form of CSR addressed in this Section. The first is nonprofit or alternative-purpose corporations, such as benefit corporations and cooperatives.³⁵⁹ These corporate forms simply represent a different *ex ante* choice of corporate purpose. Every corporation must act lawfully, but not every corporation must pursue profit. The corporation’s founders, or its residual claimants, can choose to dedicate the corporation to charity, or to being part-for-profit, part-other-purposes.³⁶⁰ The only segment of the corporation’s purpose that the *law* may *always* require is the “lawful” part. By simple logic, the other, “residual” part—whether “pursuit of profit,” or anything else—cannot be legally interfered with, if it is done in full compliance with law.³⁶¹

357. *Id.* at 665 (alteration in original; citations omitted).

358. *See, e.g.*, Griffith, *supra* note 15, at 673 (“Law is what you must do . . .”).

359. *See, e.g.*, DEL. CODE ANN. tit. 8, § 362(a) (2022) (“A ‘public benefit corporation’ is a for-profit corporation . . . that is intended to produce a public benefit or public benefits and to operate in a responsible and sustainable manner. To that end, a 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. In the certificate of incorporation, a public benefit corporation shall: . . . Identify within its statement of business or purpose pursuant to § 102(a)(3) of this title one or more specific public benefits to be promoted by the corporation; and . . . [s]tate within its heading that it is a public benefit corporation.”).

360. *See id.*

361. At this point, an additional, higher-level question might come into play: should it be possible for *anyone* to lawfully seek profit? Some people might believe that “the lawful pursuit of profit” should not be a permissible corporate purpose, because the latter, subordinate part—the possibility of attaining profit, and keeping it to oneself—is illegitimate. At least under the present-day understanding of the rule of law, *see supra* Section I.A, that position is not recognized by our

This Section's discussion of CSR also does not refer to, and does not preclude, disciplining corporations through *non-legal* means.³⁶² As mentioned in the Introduction, these include reputation, consumer and employee preferences, and the capital markets.³⁶³ For example, it is possible to only invest in corporations that maintain higher environmental standards than those required by law.³⁶⁴ Indeed, this is the driving force behind the most important financial trend in recent years: ESG investing, which has grown to over \$30 trillion in scope.³⁶⁵ Equally, our law and

legal system. If we respect the values of autonomy and personal choice, it should remain this way. This also explains why it is not possible, or desirable, to require corporations to follow *both* the dictates of non-corporate law *and* open-ended CSR—as suggested, for example, in Aneil Kovvali, *Stark Choices for Corporate Reform*, 123 COLUM. L. REV. (forthcoming 2023), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4067505 [<https://perma.cc/54SE-LWJG>]. Not only would the second prong fail to add any effective claims to what stakeholders already have under the first, it would also unjustifiably impair the corporation's ability to lawfully pursue its own benefit, and the limited, residual, yet valuable and legally protected rights of shareholders. Even if there could be a corporation with no discernible *ex ante* purpose—where fiduciaries may cause the entity to (lawfully) operate in any way whatsoever, and can unilaterally create or eliminate the rights of residual claimants—the for-profit corporation (as well as, in fact, nonprofit corporations) is not such an entity, and cannot be transmuted into one.

362. This correlates with Professor Pollman's third category: “[R]eferences that are broadly stated without relation to law,” Pollman, *supra* note 31, at 665.

363. *See supra* text accompanying note 34.

364. Some policymakers tend to view ESG investing as more of a legal issue, as was the case with the Department of Labor's 2020 rule, meant to make it harder for Employee Retirement Income Security Act (ERISA) fiduciaries (namely, pension fund managers) to consider ESG factors in their investment decisions. *See* Financial Factors in Selecting Plan Investments, 85 Fed. Reg. 72,846 (Nov. 13, 2020) (codified at 29 C.F.R. pts. 2509, 2550). The 2020 rule, however, is no longer enforced. *See US Department of Labor Releases Statement on Enforcement of Its Final Rules on ESG Investments, Proxy Voting by Employee Benefit Plans*, U.S. DEP'T LAB. (Mar. 10, 2021), <https://www.dol.gov/newsroom/releases/ebsa/ebsa20210310> [<https://perma.cc/H8Z4-UNB3>]. In contrast to that rule, this Article embraces the position taken by Professors Max Schanzenbach and Robert Sitkoff: ESG investing is as legitimate as any other form of investment, assuming it is made in pursuit of the trustee's fiduciary obligations; as long as those are honored, the decision whether to engage in ESG investing is an extra-legal choice, within the trustee's professional discretion. *See, e.g.*, 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 (2020) (explaining that ESG investing is permissible under fiduciary law if the trustee reasonably believes that ESG investing will benefit the beneficiary, and the trustee's primary motive is to obtain this benefit).

365. *See, e.g.*, Jacqueline Poh, *Conflicting ESG Ratings Are Confusing Sustainable Investors*, BLOOMBERG (Dec. 11, 2019, 4:00 AM), <https://www.bloomberg.com/news/articles/2019-12-11/conflicting-esg-ratings-are-confusing-sustainable-investors> [<https://perma.cc/6BAW-GVF3>] (“ESG scores can play a key role in determining whether fund managers or exchange-traded funds buy a stock Investments in about \$30 trillion in assets have relied in some way on ESG ratings”); Karen Wong, *The World Targets Change*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Nov. 22, 2021), <https://corpgov.law.harvard.edu/2021/11/22/the-world-targets-change> [<https://perma.cc/G9X9-F9ZY>] (“In 2021, ESG investing has grown to \$35+ trillion—over a third of the world's professionally managed assets.”).

society make it possible not to buy products or services made by a law-abiding, yet “socially irresponsible,” corporation. The spread of online interactions has made it easier to overcome any collective action problems that might exist in this regard. In any event, deciding *which* law-abiding corporations are irresponsible is a task assigned—by definition—to non-legal institutions, from individuals to civil society organizations.

Once these other meanings are off the table, the following interpretation of CSR is left:³⁶⁶ first, positive law provides inadequate protection to stakeholders’ true interests (however those may be determined).³⁶⁷ The problems of non-optimal law, the compliance gap, and the enforcement gap are a constant; it is less worthwhile to address them *from within* general law and legal institutions.³⁶⁸ Because of that, any “profit” that a for-profit corporation makes—and any “net worth” remaining in its balance sheet³⁶⁹—is, in a sense, encumbered. It does not *fully* belong to the corporation, nor can it be freely distributed to its residual claimants (shareholders). Instead, stakeholders still have a legally binding claim on those resources. In other words, CSR advocates argue that, even after meeting all of its legal obligations, the corporation still has legal obligations to meet.

As defined initially, *non-corporate* law does not generate any of those extra claims. Therefore, the only legal area that can support the CSR objective is corporate law. Accordingly, CSR aims to modify the existing tenets of corporate law: as a matter of the law of corporate purpose,

366. The analysis provided here does not appear in previous literature. It relies on the conceptual building blocks discussed in this Article, especially *supra* Part I. Many advocates of the approach criticized here might not agree with every statement in the following paragraphs as representing their own views. Yet, as an analytical matter, this interpretation does reflect the operative essence of CSR (in the specific sense criticized here).

367. See, e.g., Tim Wu, *The Goals of the Corporation and the Limits of the Law*, CLS BLUE SKY BLOG (Sept. 3, 2019), <https://clsbluesky.law.columbia.edu/2019/09/03/the-goals-of-the-corporation-and-the-limits-of-the-law> [<https://perma.cc/VNT4-AX8Q>] (“[T]he pass the buck approach [(placing the burden on government-created law, rather than corporations’ own policies, to address social problems)] . . . is extraordinarily optimistic about both the ability and likelihood of government doing that which the corporation is being asked to ignore. . . . [This approach] ignores public choice theory and the obvious incentives of corporations who are told to maximize shareholder welfare to prevent the legal system from actually providing protections that might decrease corporate profit. . . . [I]t grandly overestimates the legal system and what it can realistically do for people.”).

368. Cf. *supra* text accompanying notes 52–60 (discussing these three problems, which are the primary sources of CSR advocates’ concerns, and suggesting that they can be alleviated by improving the substance and enforcement of non-corporate law).

369. See, e.g., Raz, *supra* note 110, at 273 (explaining that a corporation’s net worth, or “residual,” equals the difference between the corporation’s assets and its non-corporate positive law obligations).

corporations may not engage in the lawful pursuit of profit.³⁷⁰ As a matter of corporate fiduciary law, directors and officers *may*, or are *obliged* to (current CSR discussion does not clearly make this choice), distribute the corporation's surplus however they decide, among various stakeholders.³⁷¹ Finally, as a matter of share law, or the law of residual claims, shareholders cannot know what they are entitled to (if anything): the legal and financial concept of "shareholders' equity" becomes hollow, since any part of the corporation's net worth may be distributed, at any given moment, to one stakeholder or another.³⁷²

Similarly, in its day-to-day operations, the corporation may, or is obliged to, cease pursuing lawful profit, instead aiming for "just a little bit less" profit, or no profit at all—this being framed as "conduct[ing] business beyond compliance with the law and beyond shareholder wealth maximization."³⁷³ In practical litigation terms, CSR, if implemented, would mean one of two things: either (1) entities and shareholders will no longer be able to sue fiduciaries, under the *Stone*³⁷⁴ good faith doctrine, for steering the corporation away from its purpose (by failing to cause it to engage in the lawful pursuit of profit);³⁷⁵ or (2) in addition,

370. See, e.g., Accountable Capitalism Act, S. 3348, 115th Cong. § 5(b)(2) (2018) (a legislative proposal requiring corporations to act in furtherance of a "general public benefit").

371. See, e.g., Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 325 (1999) ("[C]orporate directors as mediating hierarchs enjoy considerable discretion in deciding which members of the corporate coalition receive what portion of the economic surplus resulting from team production. Although the board must meet the minimum demands of each team member to keep the coalition together, beyond that threshold any number of possible allocations among groups is possible.").

372. See *id.* Professors Blair and Stout might have used the term "surplus" in a more economic, rather than legal, manner. This surplus possibly means any economic pool over which directors exercise discretion. Under present-day corporate law, it is indeed possible, in furthering the corporation's purpose, to increase employees' compensation, to be generous toward consumers and suppliers, and so forth. See, e.g., *Shlensky v. Wrigley*, 237 N.E.2d 776, 780 (Ill. App. Ct. 1968) (explaining that corporate decisions made to prevent the surrounding neighborhood from deteriorating could also be in the best interests of the corporation and the stockholders); *Raz*, *supra* note 19, at 553–54 (explaining that in *Paramount Communications, Inc. v. Time Inc.*, 571 A.2d 1140 (Del. 1989), Time could validly defend its culture in the face of a hostile takeover attempt, because doing so promoted the corporation's purpose). In legal terms, this often means that stakeholders are endowed with some Hohfeldian rights. The content of those rights may be determined *ex ante*—for example, a monthly salary; or *ex post*—for example, an annual bonus, or a wage increase. Under the legal primacy norm, once a stakeholder acquires a valid legal right, whether due to directors' good faith business decision or otherwise (say, as a result of new legislation), that right must be honored, and is senior to any shareholder claim. Alternatively, it is possible to use the term "surplus" to refer to the pool of Hohfeldian rights remaining *after* all of those non-corporate legal rights are accounted for. That pool is also known as "shareholders' equity," and for a good reason.

373. Lin, *supra* note 31, at 64, *quoted in* Pollman, *supra* note 31, at 665.

374. *Stone v. Ritter*, 911 A.2d 362 (Del. 2006).

375. See *supra* Section II.A (discussing fiduciary good faith as linked to the promotion of the corporation's purpose).

stakeholders *will* have an enforceable claim, against the entity and its fiduciaries (derivatively or directly?), for not operating in the manner which the plaintiff argues is “socially responsible.” Existing scholarship does not clearly discuss, or make, any of these choices (and, consequently, fails to grapple with the impracticality of each).³⁷⁶

The shortcomings of this conceptual approach are multiple. They would negatively affect not just corporations and shareholders (the focus of previous CSR-critical writing),³⁷⁷ but also—as this Article’s examination of the legal primacy norm reveals—stakeholders themselves. The core reason for this is apparent: if CSR advocates believe that law is an inherently inadequate mechanism for securing stakeholders’ interests³⁷⁸—if, indeed, it is less worthwhile to try improving the substance and enforcement of the “bodies of positive law that constrain corporate behavior”³⁷⁹—how can it be that the solution proposed by CSR advocates is, in fact, law?

More specifically, that proposed solution is *corporate* law, with its minimal content of *ex ante* duties, heavy reliance on the business judgment rule, and general goal of creating entities with license to engage in open-ended activities.³⁸⁰ Non-corporate law is unlikely to provide the best imaginable answers, but it *is* superior to corporate law, in terms of supplying concrete, enforceable protections for stakeholders. This fact is

376. If the first approach (zero enforceability of corporate purpose) will be implemented, the problems identified *supra* note 361 and *infra* note 377 would arise. If the second approach (open-ended stakeholder claims in the corporate law courtroom) is chosen, there also would be no reference against which directors’ compliance with CSR could be measured. Which stakeholder demands are more important than others? For instance, should Uber Technologies, Inc. withdraw from its business, given the plight of taxi drivers? If, instead, Uber should be “just a bit more” mindful of that group, what number of saved jobs, or other metric, would justify denying a lawsuit against Uber or its fiduciaries in a corporate law court? More broadly, what *does* it mean to pursue “general public benefit,” Accountable Capitalism Act, S. 3348, 115th Cong. § 5(b)(2) (2018)? Importantly, once any of these stakeholder interests become protected by positive law, they exit the realm of CSR by definition, and turn into a matter of law enforcement and the legal primacy norm. As long as this balancing act is *not* done by law, it is difficult to see how imposing an open-ended, practically unenforceable duty on the fiduciaries of millions of public and private corporations, each with their own, diverging idea of “social responsibility,” could improve the situation of stakeholders in any coherent manner. More likely, it would generate “blanket pulling,” wasteful litigation, and unfairness toward *all* involved actors: entities, stakeholders, shareholders, and fiduciaries. For a similar, highly detailed argument, see Robert T. Miller, *How Would Directors Make Business Decisions Under a Stakeholder Model?*, 77 BUS. LAW. 773 (2022).

377. See, e.g., *In re Trados Inc. S’holder Litig.*, 73 A.3d 17, 42 n.16 (Del. Ch. 2013) (“[A] multivariate fiduciary calculus quickly devolves into the equitable equivalent of a constituency statute with a concomitant decline in accountability.”); EASTERBROOK & FISCHER, *supra* note 125, at 38 (“[A] manager told to serve two masters . . . has been freed of both and is answerable to neither.”).

378. See, e.g., Wu, *supra* note 367.

379. Strine, *supra* note 7, at 790.

380. See Raz, *supra* note 26, at 267–77.

inherent in the structure of corporate law. The imperfect, but preferable solution—improving non-corporate law, or as Chief Justice Strine called it, “the harder work involved in real reform”³⁸¹—is already taking place, every day, in legislatures, courts, and regulatory agencies.³⁸²

Although Strine³⁸³ and Pollman³⁸⁴ are right to criticize the decline in power of certain areas of positive law—a problem which, as they point out, originates from as high as the U.S. Supreme Court—this does not mean that corporate law would do better. Instead, as Professor Mariana Pargendler observed, “the promise of corporate governance may have been overrated, . . . [as it] may crowd out potentially more effective responses to the problems at hand.”³⁸⁵ As much as we would like such an immediate solution to appear, corporate directors and officers, at least based on the prospect of Delaware fiduciary litigation (with its “overwhelming deference provided by the business judgment rule”³⁸⁶), will not overturn *Citizens United*³⁸⁷ or *Hobby Lobby*.³⁸⁸ Proponents of CSR might be motivated by a valid desire to find a single, central location to deal with many important concerns (from workers’ conditions to the environment), but that location is simply not corporate law. In fact, delegating social policy to the directors of *millions* of private and public corporations would be the precise opposite of finding such a focal point. Fortunately, a more centralized solution does exist, even if it needs improvement: non-corporate positive law.³⁸⁹

As a result, CSR advocates bear a heavy burden in establishing that the justified demands for better stakeholder protections should be implemented within corporate law, rather than in external legal frameworks. Not only would it be illogical, and possibly unconstitutional, to demand *more* obedience from an entity that fully complies with law, but it would also make no sense to try reforming the corporate-specific concepts of purpose, fiduciary duty, and shareholders’ rights, when other, less open-ended, and more easily enforceable concepts—such as tort law doctrines, environmental law statutes, or administrative proceedings

381. Strine, *supra* note 7, at 788.

382. *See, e.g., supra* note 53 and accompanying text.

383. *E.g.* Leo E. Strine, Jr., *Corporate Power Ratchet: The Courts’ Role in Eroding “We the People’s” Ability to Constrain Our Corporate Creations*, 51 HARV. C.R.-C.L. L. REV. 423 (2016).

384. Elizabeth Pollman, *The Supreme Court and the Pro-Business Paradox*, 135 HARV. L. REV. 220, 226, 246 (2021).

385. Pargendler, *supra* note 11, at 402.

386. James D. Cox, *Corporate Law and the Limits of Private Ordering*, 93 WASH. U. L. REV. 257, 264 (2015).

387. *Citizens United v. FEC*, 558 U.S. 310 (2010).

388. *Burwell v. Hobby Lobby Stores, Inc.*, 573 U.S. 682 (2014).

389. This solution is “centralized” because, as a general matter, law is created in relatively few places (such as legislatures, courts, and regulatory agencies). *See, e.g., supra* note 53. Once created, the law applies to all the people in a given jurisdiction.

against corporations—can be strengthened. Even from a pure stakeholder perspective, the effective place to pursue reform is not the Delaware Court of Chancery, but more well-recognized avenues: from Congress, through federal agencies, to state legislatures and common law courts.³⁹⁰

CSR's burden is made even heavier by the fact that present-day corporate law *already* puts stakeholders front and center, by requiring the fulfillment of their positive law rights. Ironically, just like the shareholder primacy advocates discussed above,³⁹¹ CSR proponents often fail to acknowledge this fundamental fact: the legal primacy norm, around which many familiar aspects of corporate law are organized, including the residual nature of shareholders' rights, and the increasingly court-enforced doctrines discussed in Part II, such as fiduciary good faith, *Caremark*, and the mandatory limits on dividends and buybacks. Instead, CSR advocates raise the counterfactual argument that, under existing law, "constituents . . . get no rights."³⁹² In reality, not only do stakeholders get rights against the entity under non-corporate law, but those rights are also derivatively protected, against the entity's fiduciaries and shareholders, under corporate law's internal doctrines.

Finally, when one considers the increasing role of yet additional mechanisms that shape corporate behavior—such as ESG investing, and the growth of benefit corporations³⁹³—the case for CSR, in the specific sense analyzed in this Section (and prevalent in today's discussion), becomes truly minimal. In a broader sense, however, corporate social responsibility remains a valid, desirable policy goal. As the legal contours of CSR continue to develop, the focus should be on those tools—non-corporate law, combined with corporate law's legal primacy norm—which already work in practice, and can best define and promote the legitimate interests of stakeholders, entities, and shareholders alike.

390. See, e.g., Leo E. Strine, Jr, *Corporate Power is Corporate Purpose I: Evidence from My Hometown*, 33 OXFORD REV. ECON. POL'Y 176, 177 (2017) ("Pretending that corporate boards—an odd recourse for ordinary people anyway—are to be looked at as a source of protection and solace for workers, the environment, and consumers dilutes the focus that is actually needed, which is on the protections from externalities that other constituencies deserve.").

391. See *supra* notes 337–55 and accompanying text.

392. William W. Bratton, *The Separation of Corporate Law and Social Welfare*, 74 WASH. & LEE L. REV. 767, 773 (2017). This way of thinking is fairly common, including in popular discourse and non-legal writing. See, e.g., WILLIAM H. SHAW & VINCENT BARRY, MORAL ISSUES IN BUSINESS 234–35 (11th ed. 2010) ("[A]ccording to proponents of the narrow view, management has a fiduciary duty to maximize shareholder wealth, a duty that is inconsistent with any social responsibility other than the relentless pursuit of profit. . . . [These advocates] stress that management's fiduciary duty to the owners (stockholders) . . . takes priority over any other responsibilities and obligates management to focus on profit maximization alone."). Even if some commentators have made similar statements, see *supra* Section III.A, they do not, and never did, represent actual corporate law.

393. See *supra* notes 359–65 and accompanying text.

CONCLUSION

Since the rise of legal realism, large parts of the American legal community have become averse to nuance. A common mode of thinking—in law and broader society—can be described as: “If it’s not happening in the headlines, it’s not happening.”³⁹⁴ This problem has been starkest in corporate law scholarship, where the discourse is characterized by a dichotomy between two notions, known as “shareholder primacy” and “corporate social responsibility.” Curiously, each of the two emphasizes some facets of corporate law and the broader rule of law—the core elements of which are explored in Section I.A above—while overlooking other aspects: shareholder primacy advocates tend to view the corporation as a rarefied “nexus of contracts,” where fiduciary duties run directly and only to shareholders, and the corporation’s sole purpose is the pursuit of profit. Proponents of corporate social responsibility, on the other hand, discount the possibility of pursuing profit within the bounds of law, and call for an open-ended, but rarely well-specified, duty of maximizing “general public benefit.”³⁹⁵

As this Article has explained, these polar conceptions are misplaced. Neither approach fully coheres with what corporate law says (and has been saying for a long time). In fact, the relation between public-regarding behavior and profit-seeking is not a dichotomy, but a hierarchy. As discussed in Sections I.B and I.C above, a for-profit corporation can and should pursue profit, but well before that, corporate law—in tandem with external, non-corporate law—insists on a strong norm of *legal primacy*: the corporate entity must comply with all of its positive law obligations, coming from any area of law, without exception (whether civil or criminal, private or public law).

We are closely familiar with this requirement when it arises *outside* of corporate law: consider, for example, the opioid litigation, or the recent antitrust case against Google. Yet, as this Article has shown, a powerful array of doctrines and concepts, organized around the unifying principle of legal primacy, operate *within* corporate law itself to maximize the entity’s legal obedience. According to well-established law, shareholders may not interfere with other stakeholders’ claims against the corporation, nor receive any economic value as long as the corporation has not met, or is unable to meet, its other obligations. The rights and powers that shareholders do hold—such as voting for directors, or influencing corporate behavior through other forms of activism and market

394. Chris William Sanchirico, *Win or Lose on Amazon, Philly Needs to Get Smart About Attracting New Businesses*, PHILA. INQUIRER (Oct. 25, 2017), <https://www.inquirer.com/philly/opinion/commentary/amazon-hq2-philadelphia-business-kennedy-20171025.html> [<https://perma.cc/SY5J-ZVV3>].

395. Accountable Capitalism Act, S. 3348, 115th Cong. § 5(b)(2) (2018).

pressure—are constrained by the requirement of lawful behavior by all involved actors.

The other group of people at the center of corporate law adjudication and scholarship—the corporation’s directors, officers, and other fiduciaries—are equally subject to the legal primacy norm. This requirement materializes through an extensive set of legal doctrines, explored in Part II above. These include the fiduciary duty of good faith; directors’ oversight duties under the *Caremark* doctrine; the mandatory limits on dividends and buybacks; the shift in corporate purpose in the vicinity of insolvency; the seniority of preferred shareholders and trust shareholders; and the judicial dissolution of law-breaking corporations. In each case, substantial remedies can be imposed—by corporate law courts, based on corporate law notions of equity and fiduciary duty—for failing to cause the corporation to comply with external, non-corporate law. In recent years, many of these doctrines have moved to the heart of corporate law practice and literature, and that trend is likely to continue. This Article explains why it should.

Given the practical strength, and the structural, mandatory role of the legal primacy norm within corporate law, it is time to reconsider the two prevailing approaches (or at least their current interpretation): shareholder primacy and corporate social responsibility. Part III above does so. As to the former—shareholder primacy—corporate law clearly mandates that there can be no profit except *lawful* profit. Shareholders have the opposite of “primacy”: they are the most junior, subordinated claimants toward the corporation, and cannot validly do anything, or obtain any value, to the detriment of stakeholders’ legal rights. This fact is also grounded in concepts, such as the corporation’s entity nature, which directly contradict imprecise metaphors like “nexus of contracts,” or agency costs that subsist directly between managers and shareholders—both touchstones of contractarian and shareholderist writing over the last half-century.

As to the latter—the CSR approach—this Article has demonstrated that moving away from positive law, and into a less precisely defined concept of “social responsibility,” would first be unfair toward corporations and shareholders, who—like any other person—have rights, not just duties, and may pursue profit within the bounds of law. Moreover, the present-day understanding of CSR would do a disservice to stakeholders themselves. Corporate law *already* places stakeholders at its very center, based on the presence of positive law rights arising in other areas of law, which the corporation—and, derivatively, its fiduciaries and shareholders—are obliged to respect. It would be a mistake to leave behind the powerful duo of non-corporate law and the legal primacy norm, instead emphasizing free-ranging CSR, where most attempts at enforcement would be foreclosed by the open-ended, *ex post*

nature of corporate activity, and directors' strong protections under the business judgment rule and similar doctrines.

There are two additional implications to the framework presented in this Article, which should also receive continued attention in scholarship and broader discourse. First, the argument provided here poses a substantial challenge to the view of the corporation as a "nexus of contracts," and the related belief that corporate charters and bylaws can be treated as contracts. The legal primacy norm adds new depth to the understanding of the corporation as a separate legal person—which is not itself a contract, but can *enter into* contracts, as well as myriad other legal relationships, including decidedly non-contractual ones (such as those under tort or environmental law). The corporation is a uniquely free-acting entity, whose capacity to shape the world around it is not, cannot, and should not be delimited in any *ex ante* contract. At the same time, the corporation's open-ended endeavors are subject to the requirement of lawful behavior, which no contract can alter.

This further relates to the fact that, contrary to much of the existing literature, corporate law is not only, or even predominantly, about agency costs between managers and shareholders. The latter can never have the power to limit fiduciaries' duties, eliminate them, or make them less enforceable. That is primarily because those duties are not owed to them, but to the corporate entity—which, in turn, has legal contacts with more than its shareholders. The doctrines surveyed in this Article, such as *Caremark* and the mandatory limits on dividends and buybacks, illustrate how stakeholders are fully a part of the corporate law calculus, which requires a set of enforceable fiduciary and equity-based tools to operate correctly. Therefore, this Article reinforces the argument that the various one-sided maneuvers being used (or contemplated) to prevent meaningful judicial supervision over corporate and fiduciary conduct—including, in a roughly increasing order of severity, forum selection clauses, special committees, fiduciary duty waivers, and mandatory arbitration—cannot be justified on the false assumption that corporate law is contractual in nature.

The second implication is that legislators, judges, regulators, and practicing lawyers should be mindful of legal primacy as a grounding principle of corporate law, and use it liberally when creating, interpreting, or arguing statutes, cases, and other legal materials. For example, even if the corporate statute in some jurisdiction does not explicitly (or adequately) condition the distribution of dividends on the corporation's continued ability to meet its obligations, courts should equitably read such limits into the law, when faced with a lawsuit by, say, a harmed creditor against a controlling shareholder. The latter cannot possibly have a right to frustrate stakeholders' legal claims, as a matter of first principles and the rule of law. Similarly, when drafting the next

amendment to their jurisdiction's corporate statute (or related regulations), lawmakers should refer to the set of doctrines discussed in Part II above, and make sure that those are covered. In fact, this should precede legal reforms dealing with the (separately important) rights of shareholders.

To be certain, the law is far from perfect. This Article has offered a taxonomy of the various shortcomings that law can exhibit: first, law is sometimes not optimal; second, law is sometimes not obeyed; and third, law is sometimes not enforced.³⁹⁶ These problems might never go away entirely, but it is precisely the role of legislators, judges, regulators, practicing lawyers, and scholars to alleviate them. In any event, attempting to find refuge from (non-corporate) law in (corporate) law is impossible, as a matter of both logic and fairness. Different people, in different situations, acquire rights and duties under different areas of law. A less recognized fact, on which this Article has shed light, is the consistency with which corporate law subordinates itself—and its internal actors, namely entities, shareholders, and fiduciaries—to all other legal imperatives.

396. See *supra* text accompanying notes 52–60.