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Four political and sociological myths that continue to play important roles in law are examined. These are: (1) the myth that corporations are owned by their shareholders and represent ownership interests in businesses rather than mere financial claims on the cash flows of those businesses, coupled with certain political (voting) rights that protect those claims; (2) the "shareholder value myth," that corporate officers and directors are legally required to maximize firm value; (3) that subsidiary companies are independent from and not subject to the control of their parent companies and must remain so in order for the parent company to avoid liability for the contract and tort debts of the subsidiary under various alter ego and piercing the corporate veil theories of corporate law; and (4) the legal regulation of insider trading is justified because of the necessity of creating a "level playing field" among participants in financial markets. Reasonable people can disagree about whether the role played by these myths is normatively positive or negative in each of these contexts.

Keywords: corporations, myth, legitimization

JEL Classifications: K2, K22, L21, L22, L51, P12

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THE CENTRAL ROLE OF MYTH IN CORPORATE LAW

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ABSTRACT

This Article shows that a variety of fundamental rules of corporate law are based on a set of myths. The Article explains that these myths play an important role in attracting public acceptance and support for what otherwise would be unpopular and controversial regulations. Thus, one can view the role played by myth in corporate law in a particular context as having either positive or negative social effects depending on one's opinion of the social value of the underlying legal rule that being buttressed and affirmed by the myth.

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I. *Introduction*

The thesis of this Article is that corporate law is based on a number of basic principles and assumptions that have neither factual basis nor historical validity. These "principles" are actually political myths,[1] which, though false, serve the function of influencing people's thinking in important ways.[2] Like myths in general, political myths often are not even remotely accurate as factual accounts of the world. And, like myths generally, despite being inaccurate descriptively, the political myths analyzed here serve a significant palliative role in society, making the central societal role played by corporate law in American life more politically and culturally acceptable and more apparently consistent with societal values.[3]

The corporate law myths identified and analyzed in this article serve precisely the same conservative societal political function that myths serve generally. The specific political purpose of myth "is to stabilize the existing regime, to afford infallible precedents for practice and procedure, and to place on an unassailable foundation the general rules of conduct, traditional institutions and the sentiments controlling social behavior."[4] Myths are designed "very often to fill a gap in scientific knowledge and philosophical reasoning" where such a gap requires filling in order to explain custom, habit, law or regulation.[5]

Four fundamental principles or canons, of corporate law are examined

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[1] A "political myth" is a particular kind of narrative that provides legitimacy to a particular facet of a legal system. More specifically, a political myth is "an ideologically marked narrative which purports to give a true account of a set of past, present, or predicted political events and which is accepted as valid in its essentials by a social group," CHRISTOPHER G. FLOOD, POLITICAL MYTH: A THEORETICAL INTRODUCTION (2001). The social function of political myth is to provide a narrative through which we orient ourselves, and that instructs us about how to act and feel about our political world. CHIARA BOTTICI, A PHILOSOPHY OF POLITICAL MYTH (2010).

[2] T.L. THORSON, A HISTORY OF POLITICAL THEORY 14 (4th ed. 1973). ("It is the mark of a modern mind to be able to explicitly create a "myth" as a way of influencing others."). Plato utilized myth in this way in The Republic. THE REPUBLIC OF PLATO (Alan Bloom trans. with Adam Kirsch) (2016).

[3] For ease of exposition, the simple term "myth" will be used to describe the political myths discussed in this Article.

[4] E.O. James, *The Nature and Function of Myth*, 68 FOLKLORE 474, 476 (1957). Thus, contrary to a "true myth… is not an aetiological tale invented to explain objects and events that arouse attention." *Id*. at 475.

[5] *Id*.

here. These are that: (1) public companies "belong" to their shareholders; (2) the goal of corporate law is to maximize shareholder wealth as measured by share price; (3) corporate law requires that parent companies be managed and operated separately from their subsidiaries and affiliates; and (4) the purpose of disclosure rules in general and insider trading law in particular is to eliminate "asymmetries of information" by creating a "level playing field" among market participants.

The central claims of this Article are that all of these principles are descriptively inaccurate and that they are best understood as myths, rather than as social norms or legal theories. These canons are best described as myths because, unlike social norms or legal theories, they do not describe either actual states of the world or desired states of the world. Specifically, the legal phenomena described here are not laws because they are in no way binding. And, while they resemble norms more closely than they do laws, they are not norms because norms consist of socially accepted behavior that individuals are expected to conform to in a particular group, community, or culture. Norms generally serve the role of serving as a guide to appropriate or acceptable behavior. In fact, the opposite is true of the principles described here.

Unlike norms, the four principles described here are not guides to appropriate or acceptable behavior because corporate actors are not expected to conform to them. Rather, they describe patterns of behavior and states of the world that are not just unobservable as a matter of fact, but that should not exist or cannot exist in the real world. Thus, while the principles discussed in this Article generally are presented as social norms or legal theories, they are more accurately described as myths. Similarly, the principles discussed in this Article are more properly described as myths than as fallacies. Fallacies are simply misconceptions and telling them serves no particular function or purpose. Fallacies, in other words, are a form of lie. In contrast, myths are false beliefs or fictional stories. Generally, the term 'myth' refers to a belief that is (or was) held to be true or was a part of human society at some point.

Like many myths, the mythical legal principles identified here serve important social functions.[6] In particular, they are a mechanism through which the complex social and economic and contractual relationships that define the publicly-held corporation can be easily explained. Moreover, although these principles do not describe the way that the world accurately works, these norms and principles describe something almost as interesting.

[6] Bronislaw Malinowski was the first theorist to study myths in the historical context in which they were considered to be true. Malinowski understood the practical and functional role of myth in society. *See* MALINOWSKI AND THE WORK OF MYTH (Ivan Strenski ed.) (2014).

Interestingly, while each of the canons described here is false as a description of the world, each of them describes the way that elites would prefer the world to be perceived by non-elites.

Specifically, public companies do not "belong" to their shareholders but the belief that they do is a convenient myth because it legitimizes corporations as entities whose existence benefits those who invest in them. Further, the statement that the goal of corporate law is to maximize shareholder wealth as measured by share price has a palliative effect on investors, and masks the reality that corporate managers have largely unfettered discretion to manage their businesses as they see fit. We say that corporate law requires that parent companies be managed and operated separately from their subsidiaries and affiliates, but the reality is far different and actually following this "practice" would impose significant operational inefficiencies on corporate groups.

Finally, the notion that the purpose of mandatory disclosure and the regulation of insider trading law is to eliminate "asymmetries of information" by creating a "level playing field" among participants in trading markets likely has succeeded in galvanizing massive public support for regulating insider trading, the ineluctable reality is that trading is fundamentally driven by informational asymmetries. Markets could not function without such asymmetries. And, while mandating disclosure and regulating insider trading does serve important economic objectives, these objectives relate to protecting intellectual property right in information and incentivizing people to engage in the costly process of information arbitrage which involves the search for under-valued and over-valued companies.

Part I of this Article explains the important role that myths serve in society. Of course, I am aware that most of the legal world and much of the law school world looks with disdain and contempt at theoretical approaches to law. To develop a theory of corporate law predicated on myth might appear to be beyond the realm of tolerable intellectual discourse. With that in mind, I emphasize as forcefully as I can that my characterization of various legal canons as "myths" is not a negative portrayal or depiction, at least not entirely. While the term "myth" describes a story that is not objectively true, it also is the case that myths articulate and solidify society's values and norms, and provide a pattern of behavior meant to be emulated.[7] As such, despite their lack of veracity, myths have the potential to play a powerful, positive role in social ordering.

Beyond being aspirational in nature, myths often are meant to instruct. In particular, I believe that I can show that myths play the same role in corporate law as they sometimes played in Plato's dialogues. Plato's purpose

[7] Lauri Honko, *The Problem of Defining Myth*, *in* SACRED NARRATIVE: READINGS IN THE THEORY OF MYTH 49 (Alan Dundes ed., Univ. of Calif. Press) (1984).

in invoking myth was "to inculcate in his less philosophical readers noble beliefs and/or teach them various philosophical matters that may be too difficult for them to follow if expounded in a blunt, philosophical discourse."[8]

In particular, I argue that in such disparate but important areas of corporate law as mandatory disclosure and insider trading, piercing the corporate veil and the obligation to manage the firm in the best interests of the shareholders, what passes for generally accepted theory in corporate law are actually and more accurately described as myths about how the world works that are at sharp variance with reality. This gap between myth and reality creates a constructive ambiguity in the law and should be tampered with carefully.

The argument here is emphatically not that everybody believes or subscribes to the corporate law myths described here. In particular, intellectuals, academic specialists and elites are likely to comprehend the lack of congruence between the world described by these myths and the actual world in which corporations operate. But for those who do not pretend or aspire to expertise in corporate law or finance, the myths generally are thought to be accurate depictions of the world of business and finance. And the misapprehension that these myths reflect reality facilitates an acceptance of the corporate form of business organization that otherwise might be difficult for defenders of the corporate form to achieve.

Following an introduction, this Article contains four Sections. The first section provides a primer on the nature and function of myths. Each of the subsequent sections describes a particular foundational myth about corporate law, explains why the myth just described does not reflect reality,

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[8] The way that we view the concept of myth has evolved over time. In ancient societies myths were thought to be true stories about existential issues such as the nature of reality and the origin of life. In the post-modern era, the term 'myth' has come to denote a false belief or understanding. Distinct from both ancient belief in the truth of myth and today's categorical rejection of the veracity of myth is Plato's complex and multi-faceted invocation of myths. Plato used well-known traditional myths, which he modified in a variety of ways. But he also invented his own myths which he located in traditional settings and populated with various traditional mythical characters. Significantly, Plato also developed particular philosophical doctrines that he dubbed "myths." Perhaps the most famous example of Plato's use of myth as a teaching tool to help his audience to grasp an argument is in the Phaedo, where Plato articulates his theory of recollection, which posits that knowledge is recollection. The myth is about how the soul travels around the heavens where it tries to observe true reality before it is reincarnated. Once reincarnated, however, the soul cannot remember the true reality it saw in the heavens prior to being reincarnated. The soul does, however, recollect the eternal forms it saw in the heavens when it encounters their perceptible embodiments here on earth. According to some sources, the fantastical narrative of the myth "helps the less philosophically inclined grasp the main point of Plato's theory of recollection, namely that "knowledge is recollection". *Id*.

and then articulates a theory about the valuable purpose that the myth plays in shaping public perceptions about the corporation in a positive way.

Part III explores the central fable surrounding stock ownership, which posits that owning shares in a public company somehow confers ownership rights in that company on the shareholders. Part IV debunks the myth that the goal of corporate law is to maximize shareholder wealth as measured by share price. Part V considers the mythical nature of the precept that corporate law requires that parent companies be managed and operated separately from their subsidiaries and affiliates in order to avoid veil piercing. Part VI analyzes the old canard that the purpose of insider trading law is to promote a level playing field by eliminating "asymmetries of information" among market participants.

II. A Brief Primer on Myths

In much legal scholarship the term "myth" is thrown around rather casually to connote a sloppy idea that lacks foundation and should be debunked and disregarded.[9] Here, I take the view that myths are not merely sloppy, wrongheaded ideas. Rather, myths play an important role in the law and they deserve to be taken seriously. My point is not to disparage work that invokes the term "myth" in a way that is synonymous with "fable" or "fairytale," because doing so has become commonplace. Rather my point is that the term "myth" also has a narrower, more precise meaning, and that in this Article I use "myth in this narrower sense.

As noted above, the myths identified and discussed here are "political myths" which are narratives that provide legitimacy to a particular facet of a legal system. I emphasize that the concept of providing legitimacy is purely descriptive and not normative in the least. By this I mean that the fact that the myths described here provide legitimacy to a particular facet of the legal system tells us nothing about whether that facet of the legal system *deserves* to be legitimated by the myth that surrounds

[9] *See e.g.* John M. Newman, *The Myth of Free*, 86 GEO. WASH. L. REV. 513, 513 (2018) (describing a myth as being "internal inconsistencies, logical errors, and factual inaccuracies"); Keith E. Whittington & Jason Iuliano, *The Myth of the NonDelegation Doctrine*, 116 U. PENN. L. REV. 379, 379 (2017) ("our analysis reveals that the traditional narrative behind the nondelegation doctrine is nothing more than a myth"); Brandon L. Garrett, *The Myth of the Presumption of Innocence*, 94 TEXAS L. REV. 178, 186 (2016) (describing as myth the "generally accepted ideology of a presumption of innocence and characterizing the presumption of innocence as "more lip service than an actual protection for the innocent."); Edward K. Cheng, *The Myth of the Generalist Judge*, 61 STAN. L. REV. 519, 519 (2010) (characterizing the conception of the generalist judge as mythical, and using the term "mythical" synonymously with "false").

them. In fact, reasonable people can disagree about the normative issue of whether the legal concept being legitimized deserves to be legitimized.

In legal scholarship the term "myth" is invoked *sotto voce* to describe an erroneous justification for a legal rule that actually should be discredited and delegitimized.[10] An important argument here is that there is a logical fallacy in moving automatically from the observation that a legal rule is based on a myth or on an erroneous view of the world to the conclusion that the legal rule is bad, because it often is possible to reject the myth but to embrace the legal rule. I argue that sometimes perfectly good rules are propped up by myths because the actual economic or philosophical justifications for the rules are too complex or too politically incorrect. Having said this, I emphasize that reasonable people might differ on the legitimacy of a legal rule that is propped up in myth.

Myths play an important social role in legitimating rules that are so complex that people are rationally ignorant about their true nature and justifications. Sometimes, simply, though erroneous explanations work better than the truth to justify legal rules to the general population. An obvious use of myth is the tale that babies are delivered by "the Stork," which, of course was "valuable as a way of obscuring the realities of sex and birth."[11]

A second distinct but related social role played by myths is to render uncomfortable or distasteful legal rules more palatable to the public. All four of the myths discussed here serve both of these functions. In a nutshell, these myths serve the palliative role of obscuring the ugly truths about certain legal rules and depicting them in a more attractive and politically acceptable light.

By rendering complex legal concepts simpler and more palatable, myths serve what Professor Campbell, the legendary scholar of myths,[12] has described as the "sociological function" of "supporting and validating a certain social order."[13] Professor Campbell maintained that myths served "to validate and maintain a certain sociological system: a shared set of

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[10] *Id*.

[11] Emmy Bryce, *What's Behind the Myth that Storks Deliver Babies?*, LIVE SCIENCE (June 13, 2018), https://www.livescience.com/62807-why-storks-baby-myth.html (accessed July 21, 2019).

[12] Joseph Berger, *A Teacher of Legends Becomes One Himself*, N.Y. TIMES (Dec. 10, 1988), https://www.nytimes.com/1988/12/10/nyregion/a-teacher-of-legends-becomes-one-himself.html (accessed July 21, 2019). Wolfgang Saxon, *Joseph Campbell, Writer Known for His Scholarship on Mythology*, N.Y. TIMES (Nov. 2, 1987), https://www.nytimes.com/1987/11/02/obituaries/joseph-campbell-writer-known-for-his-scholarship-on-mythology.html. Campbell was the foremost expositor of the ways in which myths shape and guide people's lives.

[13] JOSEPH CAMPBELL, THE POWER OF MYTH 39.

rights and wrongs, proprieties or improprieties, on which a particular social unit depends for its existence."[14]

Finally by way of background, I note that, unlike folk tales, which are "stories that ordinary folk tell to amuse themselves," myths, it seems, are generated not by the masses, but by elites,[15] whose role is to interpret the world for their followers.[16] In this way, myths can be seen as a supplement to the general notions in political theory in general and public choice in particular about how certain powerful elites or interest groups can control the political system and the lawmaking process.

Public choice is the study of how discrete and insular special interest groups can galvanize into effective political coalitions thereby gaining the power to influence or control the political process.[17] This power often, but certainly not always, is used in ways that create and protect rights and privileges that serve narrow interests.[18]

III. The Myth That Shareholders "Own" the Corporations in Which They Have Invested

A. The Myth

The most popular websites, those most easily accessible by a search on Google instruct the curious that corporations are owned by their shareholders. For example, according to Wikipedia:

> A corporation is, at least in theory, ***owned*** and controlled by its members. In a joint-stock company the members are known as shareholders and each of their shares in the ownership, control, and profits of the corporation is determined by the portion of shares in the company that they own. ***Thus, a person who owns a quarter of the shares of a joint-stock company owns a quarter of the company***, is entitled to a quarter of the profit (or at least a quarter of the profit given to

[14] JOSEPH CAMPBELL, PATHWAYS TO BLISS: MYTHOLOGY AND PERSONAL TRANSFORMATION 10.

[15] CAMPBELL, *supra* note 13, at 70-72.

[16] *Id.* at 106 (The elites "speak to the folk." The first impulse comes from above not from below").

[17] Jonathan R. Macey, *Some Causes and Consequences of the Bifurcated Treatment of Economic Rights and "Other' Rights Under the United States Constitution*, 9 SOC. PHIL. & POL'Y 141 (1992).

[18] *Id.*

> shareholders as dividends) and has a quarter of the votes capable of being cast at general meetings.[19]

Similarly, according to LegalZoom.com, "[s]hareholders (or "stockholders," the terms are by and large interchangeable) are the ultimate owners of a corporation. They have the right to elect directors, vote on major corporate actions (such as mergers) and share in the profits of the corporation.[20]

Similarly, Arthur Levitt, Jr. when he was the Chair of the Securities and Exchange Commission asserted that "[t]he principle that shareholders own the companies in which they invest—and are the ultimate bosses of those running them—is central to modern capitalism."[21]

Despite the lack of agreement among elites, outside of the cognoscenti, "most people—not just the public and the media, but also politicians, and even bureaucrats and the courts—seem to believe that the shareholders do, in fact, own corporations."[22] As Lynn Stout has observed, "policymakers, and business leaders routinely chant the mantras that public companies "belong" to their shareholders.[23] Some academics also embrace the belief that shareholders own the corporation,[24] although analytical support for this proposition is quite scant. For example, one can point to the definition of the word "shares" in Section 1.40(22) of the Model Business Corporation Act, which most states have adopted, which defines the term shares as "the units into which the proprietary interests in a corporation are divided,"[25] and scholars have latched onto the word "proprietary" to declare that the Model Act has made a "clear statement that shareholders are indeed the legal owners of the corporation"[26] based on the fact that proprietary is defined as "[b]elonging to a proprietor or proprietors; owned or held as property; held in private ownership."[27]

Doctrinal support is scant. Scholars direct attention to opinions such

[19] *Corporation*, WIKIPEDIA, https://en.wikipedia.org/wiki/Corporation

[20] *Owners of a Corporation*, LEGALZOOM, https://www.legalzoom.com/knowledge/corporation/topic/corporation-owners

[21] Arthur Levitt Jr., *How to Boost Shareholder Democracy*, WALL ST. J., July 1, 2008, at A17.

[22] Julian Velasco, *Shareholder Ownership and Primacy*, 2010 ILLINOIS L. REV. 898 (2010).

[23] LYNN A. STOUT, SHAREHOLDER VALUE MYTH: HOW PUTTING SHAREHOLDERS FIRST HARMS INVESTORS, CORPORATIONS, AND THE PUBLIC (2012).

[24] *Id*. *See also* LARRY E. RIBSTEIN, THE RISE OF THE UNCORPORATION 73 (2010) ("The corporation has been regarded from its inception as a legal entity distinct from its owners.").

[25] *See* 1 MODEL BUS. CORP. ACT ANN. ix & nn.1–2 (2009).

[26] Velasco, *supra* note 22, at 929.

[27] *Id*. (citing XII THE OXFORD ENGLISH DICTIONARY 655 (2d ed. 1989)).

as *Unocal Corp. v. Mesa Petroleum Corp*., in which the Delaware Supreme Court, which has several references to the duties and rights of "the corporation and its shareholders" and highlight a single, isolated instance in which the Court, apparently inadvertently, substitutes the phrase "the corporation and its owners"[28] instead. [29] Professor Velasco, a foremost proponent of the view that the corporation is owned by its shareholders has acknowledged that the Court's use of the term the corporation and its owners was a slip and admonished that "one must be careful not to read too much into statements made in passing." However, Professor Velasco manages to salvage some modicum of support for his positing, observing that "such a slip would not be likely to occur if courts agreed that corporations were not capable of being owned (by its shareholders).[30]

More convincingly, courts sometimes point out that "Delaware corporate law provides for a separation of legal control and ownership," and that "the legal responsibility to manage the business of the corporation for the benefit of the stockholder owners is conferred on the board of directors by statute."[31] And Courts, on occasion, explicitly have made the claim that shareholders own the corporation, as when they say "Delaware corporate law provides for a separation of control and ownership. The directors of Delaware corporations have 'the legal responsibility to manage the business of a corporation for the benefit of its shareholders [sic] owners.'"[32]

Beyond this scant doctrinal support in statutes and judicial opinions, the analytical support for the notion that shareholders are owners is virtually non-existent. The most that can be said, apparently, is that shareholders are owners by virtue of the fact that:

> They are involved in the management of the business. They elect directors, which is an exercise of direct control over the corporation as well as an exercise of indirect control over the business. In addition, members of top management in public corporations invariably are shareholders and often have significant holdings of the company's stock. Thus, at least some shareholders almost always are exercising direct control

[28] 493 A.2d 946, 955 (Del. 1985).

[29] Velasco, *supra* note 22, at 929, *citing* 493 A.2d 946, 952, 954, 955, 958 (Del. 1985).

[30] *Id*.

[31] Seinfeld v. Verizon Communications, Inc., 909 A.2d 117, 119 (Del. 2006) (footnotes omitted) (internal quotation marks omitted); *see also* Saito v. McKesson HBOC, Inc., 806 A.2d 113, 116 (Del. 2002), *cited in* Velasco, *supra* note 22, at 931.

[32] N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla, 930 A.2d 92, 99-101 (Del. 2007).

over the business.[33]

Perhaps the most famous intonation of the oft-used mantra that shareholders "own the corporation" is the assertion of Adolf Berle and Gardiner Means in their classic work *The Modern Corporation and Private Property*, that corporations are characterized by a "separation of ownership and control."[34] Berle and Means were alarmed that shareholders, whom they assumed to be the "owners" of the corporation, were ceding control over corporate resources and decision-making power to cadres of professional managers who actually controlled the corporation. Critically, however, Berle and Means' actual point was that shareholders had lost ownership rights and no longer acted as owners. Instead they acted as passive investors.

Riffing on Berle and Means' central, insight economists came to characterize shareholders as "residual claimants" who were nothing more than a mutant form of creditor who contracted for the right to receive a corporation's net cash flows, and who were willing to settle for being last in line in case of insolvency or financial distress because they were the most efficient bearers of the financial risk generated by the firm due to their capacity to diversify and their lack of more attractive alternative investments.[35]

B. The Reality

The argument that there is doctrinal support for the proposition that shareholders own the corporation has been seismically undermined by the fact that the leading jurist on the nation's most important court for business law understood and explicitly rejected the concept that shareholders are owners of corporations, pointing out that instead of owning corporations "[s]hareholders simply are owners of investment interests with certain contractual rights. They are not "owners" of the corporation in any sense of the word, and their relationship with the corporation is purely statutory and contractual.[36]

As discussed in the previous section, leading scholars of the

[33] Velasco, *supra* note 22, at 937, but Professor Velasco appears to acknowledge that such involvement in the management of the corporation by shareholders is a "poor determinant of ownership status." *Id*.

[34] ADOLF A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (1932).

[35] Eugene F. Fama & Michael C. Jensen, *Separation of Ownership and Control*, 26 J.L. & ECON. 30l (1983).

[36] Jonathan R. Macey & Leo E. Strine, Jr., *Citizens United as Bad Corporate Law*, 2019 WIS. L. REV. XXX (2019).

corporation from Berle and Means on the left and to Eugene Fama and Michael Jensen on the right began to describe the role of shareholders in terms that left no doubt that shareholders were something far different from owners of the corporation in any meaningful sense.

It is true that over time, property scholars moved from conceptualizing ownership as enjoying "that sole and despotic dominion which one man claims and exercises over the external things of the world, in total exclusion of the right of any other individual in the universe,"[37] and began to develop far broader and more nuanced accounts of the concept of ownership.

But even the most expansive definitions of ownership embrace the view that owners have some rights over the thing owned, even if such rights are contingent, attenuated or even non-exclusive.[38] For example, Frank Michelman developed a rather sprawling view of property rights pursuant to which "there are never any exclusionary rights. All is privilege. People are legally free to do as they wish, and are able to do, with whatever objects (conceivably including persons) are in the [commons]."[39] Under Michelman's account, every individual may use any object of property and no individual has the right to stop someone else from using the object.[40]

But shareholders do not merely lack exclusionary rights over the corporation. Shareholders do not enjoy any of the indicia or hallmarks of ownership. Corporations themselves, not shareholders, have title to corporate assets. Shareholders lack the rights to deploy corporate assets or to direct how corporate assets are used. Shareholders who attempt to enter onto corporate property (much less to occupy or to alienate it) may be charged with the crime of trespass and arrested.[41] Shareholders do not even have the

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[37] 2 WILLIAM BLACKSTONE, COMMENTARIES *2.

[38] *See* Michael Heller, *Three Faces of Private Property*, 79 OREGON L. REV. 417 (2000) (arguing that property scholarship should evolve and "push its categories to better reflect on the ground relations, and that conceptions of property rights and ownership should not impede imagination and innovation at the frontiers of property"). As Frank Michelman observed, "[w]e need some reasonably clear conceptions of regimes that are decidedly not [private property], with which [private property] regimes can be compared." Frank I. Michelman, *Ethics, Economics, and the Law of Property, in* NOMOS XXIV: ETHICS, ECONOMICS, AND THE LAW 3, 5 (J. Roland Pennock & John W. Chapman eds., 1982).

[39] Michelman, *supra* note 38, at 5.

[40] Heller, *supra* note 38, at 419-420.

[41] For example, at a shareholders meeting in 2010, Chevron arrested four shareholders and their representatives who refused to leave Chevron property after they were denied access to the meeting. Those arrested were trying to voice their concerns about environmental destruction and human rights abuses in Ecuador, Richmond, California, and Houston, Texas. Karen Hinton, *Chevron Condemned for Human Rights Abuses, Ecuador Disaster at Annual Shareholder Meeting Today: Activists Arrested Inside and Outside Chevron's Meeting Community Leaders Barred, Ejected from Annual Meeting for Exposing*

right to object when others enter onto or convert corporate property.[42]

It is literally impossible to detect any meaningful badge or indicia or ownership possessed by shareholders. As Stephen Bainbridge has observed, shareholders lack:

> the rights to possess, use, and manage corporate assets, and the rights to corporate income and assets. For example, shareholders have no right to use or possess corporate property. Management rights, of course, are assigned by statute solely to the board of directors and those officers to whom the board properly delegates such authority. Indeed, to the extent that possessory and control rights are the indicia of a property right, the board is a better candidate for identification as the corporation's owner than are the shareholders. As an early New York opinion put it, "the directors in the performance of their duty possess [the corporation's property], and act in every way as if they owned it."[43]

Shareholders, of course, have no management rights. As a matter of basic corporate law common stock merely gives shareholders a highly attenuated and contingent call on a company's net earnings. But this claim is generally conditioned by statute on the corporation being solvent, and in any case, no dividends can be paid or distributions made to shareholders unless the corporation's board of directors approves a dividend.[44] For companies

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the Truth about Chevron, CHEVRON IN ECUADOR (May 26, 2010), https://chevroninecuador.org/news-and-multimedia/2010/0526-chevron-condemned-at-annual-shareholder-meeting (accessed June 19, 2019).

[42] W. Clay Jackson Enterprises, Inc. v. Greyhound Leasing and Fin. Corp., 463 F. Supp. 666, 670 (D. P.R. 1979) (holding that even a person who owns 100 percent of the shares of a company "has no independent right which is violated by trespass upon or conversion of the corporation's property")

[43] Stephen Bainbridge, *Who Owns the Corporation?* PROFESSORBAINBRIDGE.COM (Jan. 13, 2006), https://www.professorbainbridge.com/professorbainbridgecom/2006/01/who-owns-the-corporation.html, *citing* Manson v. Curtis, 119 N.E. 559, 562 (N.Y. 1918). *See also*, Stephen M. Bainbridge, *Unocal at 20: Director Primacy in Corporate Takeovers*, 31 DEL. J. CORP. L. 769-862, (2006) (pointing out that if shareholders own the corporation, the board of directors of a target corporation would have no proper role in responding to a tender offer. The shareholders' decision to tender their shares to the bidder would no more concern the institutional responsibilities or prerogatives of the board than would the shareholders' decision to sell their shares on the open market or, for that matter, to sell their homes.). *See also* Stephen M. Bainbridge, *In Defense of the Shareholder Wealth Maximization Norm: A Reply to Professor Green*, 50 WASH. & LEE L. REV. 1423, 1427-28 (1993) (ownership is not a particularly useful concept in the corporate context).

[44] Most states follow the Model Business Corporations Act, which, in Section 6.40(c),

experiencing financial distress, stock ownership merely affords shareholders a place at the very end of a long line behind every one of the firm's contract and tort creditors.

Lynn Stout has provided yet another sound analytical basis for rejecting the notion that share ownership somehow equals actual ownership of the underlying corporation.[45] Stout had two important points to make about the flawed notion of shareholder ownership, both of which are important to the argument that much of corporate law is myth made in this Article. Stout's first point was that corporations are distinct legal entities that own themselves.[46] Stout's second point was that laymen sometimes have difficulty understanding the concept that corporations are legal entities that own themselves.[47] As Stout succinctly put it:

> Consider first (Milton) Friedman's erroneous belief that shareholders "own" corporations. *Although laymen sometimes have difficulty understanding the point, corporations are legal entities that own themselves, just as human entities own themselves.* What shareholders own are shares, a type of contact between the shareholder and the legal entity that gives shareholders limited legal rights. In this regard, shareholders stand on equal footing with the corporation's bondholders, suppliers, and employees, all of whom also enter contracts with the firm that give them limited legal

prohibits a corporation from making a distribution if, after giving it effect (1) the corporation would not be able to pay its debts as they become due in the usual course of business (this is known as the "equity solvency" test); or (2) the corporation's total assets would be less than the sum of its total liabilities plus (unless the articles of incorporation permit otherwise) the amount that would be needed, if the corporation were to be dissolved at the time of the distribution, to satisfy the preferential rights upon dissolution of shareholders whose preferential rights are superior to those receiving the distribution (this is known as the "balance sheet solvency" test). In Delaware law, the right to declare dividends is allocated exclusively to the board of directors of the Corporation. Delaware General Corporation Law Section (DGCL) Section 170(a) restricts dividend payments by allowing them to be paid only from one of two available sources. These sources are "surplus" or, in the absence of surplus, the net profits for the fiscal year in which the dividend is declared and/or the preceding fiscal year. However, even if a firm has net profits, dividends may not be paid out of such profits if "the capital of the corporation, computed in accordance with sections 154 and 244 of [the DGCL], shall have been diminished by depreciation in the value of its property, or by losses, or otherwise, to an amount less than the aggregate amount of the capital represented by the issued and outstanding stock of all classes having a preference upon the distribution of assets …." DGCL § 170(a)(2).

[45] STOUT, *supra* note 23.

[46] *Id*. at 37-38.

[47] *Id*.

rights.[48]

In her novel and provocative work, Professor Stout did not elaborate on why laymen have difficulty understanding the point that corporations are not owned by their shareholders, but rather "own themselves." In the next section of this Article, I attempt to fill in that gap.

C. The Rationale Underlying the Myth

Fostering the misperception that shareholders are owners of corporations is a highly convenient fiction. It serves a variety of purposes that likely are susceptible to being regarded as either legitimate or illegitimate depending whether one views the role of the corporation in society as salutary and benign, or as destructive and dangerous.

Specifically, the convenient fiction of shareholder ownership of the corporation makes a variety of existential features of the corporate form far more palatable than they would be if we viewed the corporation as a free-standing entity without actual owners. Thinking of corporations as having human owners makes it much easier to justify bestowing human rights on corporations. It even allows people to make the preposterous claim that corporations are actually "people."[49] Famously, in 2011 Mitt Romney was confronted on the presidential campaign trail in Des Moines, Iowa for telling a heckler advocating for corporate tax hikes as an alternative to raising personal income taxes.[50] His response to the heckler was to inform him that "corporations are people, my friend."[51] When the hecklers disagreed, shouting back, "No, they're not!"[52] Romney's rejoinder was to "chuckle slightly"[53] and retort "Of course they are. Everything corporations earn

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[48] *Id*. (citing Milton Friedman, *The Social Responsibility of Business is to Increase Its Profits*, N.Y. TIMES MAG., Sept. 13, 1970, at 32).

[49] While the fallacy that corporations are people is false, and in that sense "mythical," it is not a myth of the type of myth analyzed in this Article because it is a myth about the existential nature of the corporation. This Article focuses instead on myths about the legal nature of the corporation, such as the myth that shareholders own the corporations in which they have invested. The same holds true for the false and misguided notion that corporations are "associations of shareholders." This is an existential claim, not a legal claim. For an extended discussion of the fallacy that corporations are "associations of individuals," *see* Macey & Strine, *supra* note 36.

[50] Ashley Parker, *'Corporations Are People,' Romney Tells Iowa Hecklers Angry Over His Tax Policy*, N.Y. TIMES (Aug. 11, 2011), https://www.nytimes.com/2011/08/12/us/politics/12romney.html (accessed June 19, 2019).

[51] *Id*.

[52] *Id*.

[53] *Id*.

ultimately goes to people. Where do you think it goes?"[54]

The point here is simple. The more closely we can identify the corporation with people, the more sympathetic they become, and the less appealing they are as targets of economic or social engineering efforts. Of course, the fact that "everything corporations earn ultimately goes to people" does not make corporations people any more than the fact that everything earned by racehorses or forklift trucks (or bulldozers or stamping presses or sheet metal machinery) also ultimately goes to people.

In recent years the myth that corporations are mere extensions of the shareholders who purport to own them has been pushed even further into the realm of fantasy by Supreme Court proclamations that corporations are not mysterious or scary artificial beings at all. Instead, the corporation is an unthreatening "mere collection of men." With human and constitutional and natural rights that coincide with, and are indistinguishable from, those of the human beings who are their shareholders.[55]

Most famously, the Supreme Court's decision in *Citizens United v. FEC,*[56] which held that corporations enjoy the same free speech rights to engage in political spending as human citizens, is grounded on the erroneous theory that corporations are "associations of citizens."[57] This is demonstrably fault, in light of the fact that corporations are actually independent legal entities distinct from those who own their stock.[58] The rather illogical notion that state action limiting the rights of corporations is tantamount to and indistinguishable from state action limiting the rights of the corporations springs naturally from the myth that shareholders are owners. The notion that corporations have human rights springs inexorably from the utter fantasy that corporations in effect do not even exist but instead are mere "associations of citizens" rather than independent legal entities in their own right.[59]

i. The Myth of Ownership and Shareholder Agency

The concept that shareholders' ownership conveys at least the perception, if not the reality, of agency, provides a justification not only for giving corporations more rights, but also for giving them more power.

[54] *Id*.
[55] ADAM WINKLER, WE THE CORPORATIONS 364 (2018).
[56] 558 U.S. 310 (2010).
[57] *Id*. at 349, 354, 356.
[58] Macey & Strine, *supra* note 36.
[59] *Id*.

Specifically, the fiction that shareholders own the corporation conveys the largely false impression that shareholders have (or feel) any sense of responsibility for the actions of the corporations. To take a somewhat radically progressive view, Hanoch Dagan has offered a progressive conception of private property that incorporates commitments to social responsibility, equality and re-distribution.[60] According to this conception, ownership of private property does not merely constitute a bundle of rights, but rather an entire social institution that creates bonds of commitment and responsibility.[61] In particular, shareholders' common ownership of the corporation, to the extent it exists, conveys an aura of an institution characterized by "cooperation, support, trust, and mutual responsibility."[62]

It is not entirely clear how much, if any, actual legal (as opposed to moral) responsibility owners actually have for redistribution. But Dagan is clearly correct that ownership of a common resource such as shareholders' "ownership" in a corporation, conveys a sense of responsibility among owners. Indeed, even in the absence of actual control over the corporations, to the extent that shareholders are perceived as "owners" they naturally and inevitably will be thought to bear some measure of responsibility for the damages caused by their property. But, of course, shareholders do not ordinarily bear any responsibility for the damages caused by the corporations in which they invest.

Conceptualizing shareholders as owners, in other words, sends a signal that is flatly inconsistent with the legal fact that shareholders enjoy limited liability. Ultimately, recognition of the notion that corporations are not owned by their shareholders but that they are free-standing legal entities that "own themselves" brings the lack of human accountability for corporate actions into uncomfortably sharp focus.

ii. The Myth of Ownership: Regulation, Rights

The myth that shareholders own the corporations in which they have invested provides a justification for arguing against more stringent regulation of corporations, or at least a justification for declining to regulate corporations more extensively than flesh-and-blood human beings are regulated, as well as for not regulating corporations in ways that overlap

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[60] Hanoch Dagan, *Just Compensation, Incentives, and Social Meanings,* 99 MICH. L. REV. 134 (2000).

[61] Hanoch Dagan, *The Distributive Foundation of Corrective Justice,* 98 MICH. L. REV. 138, 149 (1999).

[62] Hanoch Dagan & Michael Heller, *The Liberal Commons*, 110 YALE L.J. 549, 573 (2001).

unduly with the ways that their shareholders are regulated. The myth that shareholders are owners also provides a pretext for bestowing constitutional rights on corporations because the myth makes it appear that depriving corporations of constitutional rights will deprive actual human beings of the same rights.

Further, closely identifying corporations with their "shareholder/owners" has led them to be characterized as "associations of individuals." In turn, this characterization has provided the core justification for Supreme Court decisions holding that corporations have the right to spend money on political elections,[63] and that certain for-profit corporations may refuse on religious grounds to comply with a federal mandate to cover birth control in their employee health plans.[64] And, of course, just as shareholders are not owners, corporations are not "associations of individuals."[65]

Framing the relationship between shareholders and their corporations as an ownership relationship rather than as a relationship in which the shareholders are mere "investors" with contractual rights creates an environment in which it appears that shareholders do not require much legal protection from strategic and opportunistic behavior by managers. While one naturally tends to assume that the owner of an asset controls that asset and can fend for herself, the same assumption is not generally made for mere investors. It is thought that investors are subject to all sorts of moral hazard problems and therefore require high levels of consumer protection. As such, the myth that shareholders "own" the corporations in which they invest benefits managers at the expense of shareholders by making shareholders appear to be less vulnerable to exploitation and opportunism than they actually are.

Thus, the notion that shareholders are owners of the corporation implies not only that corporations should have more rights as against the state, but also that shareholders should have more rights as against the corporation than they otherwise would have. Certain rights that are not ordinarily afforded to mere investors. In particular, calls by regulators and academics for more "shareholder democracy" has emotional appeal to laymen, the business media, and even many business experts. As Lynn Stout has observed, among other justifications for expanding shareholder rights, the "emotional appeal of shareholder control can be traced to … a common but misleading metaphor that describes shareholders as the "owners" of

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[63] Citizens United v. FEC, 558 U.S. 310 (2010).

[64] Burwell v. Hobby Lobby Stores, Inc., 134 S. Ct. 2751 (2014) (holding that the Affordable Care Act contraception mandate, at least as applied to a closely held for-profit corporation, violated the Religious Freedom Restoration Act).

[65] Macey & Strine, *supra* note 36.

corporations."[66]

The notion that shareholders are owners also leads to the conclusion that market-based contracting processes that are generally considered capable of protecting most investors cannot protect shareholders. Starting with Jensen and Meckling, a vast economic literature has emerged on "agency costs" in corporations. This literature models shareholders as participants in an agency relationship in which the shareholders are the "principals" and the directors as their "agents."[67]

Because of the vast divergence in interests between managers/agents and their shareholder/owner/principals, the ordinary contracting process is not sufficient to protect shareholders. A much higher level of protection is required for shareholders than is required for other claimants on the cash flows of the firm such as workers, suppliers, and customers. In corporate law, of course, the higher levels of protection required by shareholder/owners are manifested in the special fiduciary duties, the duty of care and the duty of loyalty, that, when owed, are owed exclusively to shareholders,[68] and the general (though not universal) rule that shareholders have exclusive rights to elect the corporate directors who manage the firm strategically and appoint the officers who manage the firm on a day-to-day basis.

While shareholders' exclusive voting rights as well as their status as the sole beneficiaries of fiduciary duties is entirely consistent with the mythical account that shareholders "own the corporation," it is not consistent with the economic theory of the nature of the corporation. As Ronald Coase observed in his classis work on the theory of the firm, firms and markets are both fundamentally defined by a complex system of contractual relationships. [69] As such firms and markets can best be viewed as "alternative forms of contracting,"[70] in which the choice of whether to contract across markets or within firms is determined by which of these alternative approaches is more effective at minimizing the inherent transaction costs that characterize the contracting process.

The point here is simple. To the extent that shareholders are owners, the immutable and exclusive nature of fiduciary duties makes a lot of sense.

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[66] Lynn A. Stout, *The Mythical Benefits of Shareholder Control*, 30 REGULATION 42, 42 (2007).

[67] Michael C. Jensen & William H. Meckling, *Theory of the firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 305-360 (1976).

[68] Traditionally, "the directors of a publicly held corporation owe a duty to only one constituency, their shareholders." George S. Corey, M. Wayne Marr, Jr. & Michael F. Spivey, *Are Bondholders Owed a Fiduciary Duty?,* 18 FLA. ST. U. L. REV. 971 (2017).

[69] R.H. Coase, *The Nature of the Firm*, 4 ECONOMICA 386 (1937).

[70] William Bratton made this apt and succinct description of Coase's insight, *see* William W. Bratton, *The "Nexus of Contracts" Corporation: A Critical Appraisal*, 74 CORNELL L. REV. 407, 416 (1989).

On the other hand, if the shareholders' relationship with the corporation is more accurately viewed from a purely contractual perspective, then mandatory fiduciary owed exclusively to shareholders cannot be justified or explained. To the extent that the corporation is a nexus of contracts, shareholders are not entitled to any special or exclusive rights that are not available in the bargaining process to any claimants.

Significantly, recent events have demonstrated as clearly as any natural experiment can that shareholders are in fact mere contractual claimants whose rights are no more precious or inchoate than those of any other contracting party. Specifically, in recent years, the limited liability company ("LLC") form of business organization has emerged as a powerful rival to the traditional corporate form. In Delaware and many other states, the most notable feature of the LLC form of business organization, and the feature that distinguishes LLCs most clearly from corporations is the explicit legislative recognition that the LLC business form is based on principles of contract rather than tort of property. As such, investors in LLCs, including equity investors (who are called "members") are not treated like owners, they are treated like contractual counterparties who must, like any other contractual claimant on the cash flows of the firm, bargain for whatever levels of contractual protection they enjoy. Specifically, the LLC statute in Delaware, and elsewhere specifically provides that the guiding policy of the law of LLCs is "to give the maximum effect to the principle of freedom of contract and to the enforceability of [LLC] agreements."[71] The basic approach of the Delaware Limited Liability Company Act is to give maximum effect to the principal of freedom of contract and the enforceability of LLC Agreements."[72]

Consistent with this approach, investors in Delaware LLCs may modify or eliminate the traditional fiduciary duties owed to shareholders. Where fiduciary duties are eliminated, the claim that there is a basis in law for that shareholders "own" the corporations merely because they own shares of stock vanishes entirely because shareholders in this legal environment are purely contractual claimants, whose only rights are the contractual rights that they have bargained for.

The myth that shareholders "own" the corporations in which they invest influences the way that the corporation is perceived in society and under the law. The perception that shareholders own the corporations in which they have invested supports expanded and special super-contractual protections for shareholders as distinct from other claimants. The concept that shareholders are owners also supports the burgeoning judicial trend of treating corporations either explicitly as people, or as institutions with human

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[71] Del. G.C.L. § 18-1101(b)

[72] Elf Atochem N. America, Inc. v. Jaffari, 727 A.2d 286, 291 (Del. 1999)

and constitutional rights equal to those enjoyed by actual people. Finally, the myth that shareholders are owners imparts a veneer of legitimacy on the corporate form by anthropomorphizing the corporation to a far greater degree than would be possible if we limited ourselves to the view that the corporation was a mere, inanimate "nexus of contracts."

IV. The Myth that Corporate Law Requires Directors and Managers to Maximize Shareholder Value

A. The Myth

The myth that the law requires managers to maximize firm value is the most well-documented and intensely debated myth analyzed here. This is not surprising, because the question of shareholder wealth maximization is at the heart of the debate about the basic nature, purpose and function of the corporation.

Further, the point here is somewhat subtle, if not downright confusing, because the argument is not that corporate officers and directors *don't* maximize shareholder wealth. Rather the argument is simply that the law does not *require* that managers maximize shareholder wealth. But law is not the only thing, or even the most important thing that constrains corporate management. Officers and directors respond to incentives, and therefore are highly subject to powerful market constraints that lead them to maximize shareholder value even though the law does not.[73]

[73] *See* Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Re-valuation of Governance Rights*, 113 COLUM. L. REV. 863 (2013). Gilson and Gordon go on to argue that while "intermediary institutional investors are highly effective vehicles for financial intermediation and risk bearing," the degree to which they are specialized "gives rise to what we have called the agency costs of agency capitalism." The agency costs of agency capitalism are not the traditional agency costs that exist between shareholders and corporate managers, but between the intermediary institutional investors and their own shareholders, who are the beneficial owners of the shares that the intermediary institutional investors vote in their capacity as the legal owners of the shares. *Id*. at 863-864, 916. However the agency cost that Gilson and Gordon identify seems merely to be a lack of perfection in eliminating agency costs, and not an actual agency cost at all. In later work, Gilson and Gordon advocate for a new type of board of directors that will reduce the traditional agency costs between shareholders and corporate managers still further. Ronald J. Gilson & Jeffrey N. Gordon, 74 BUS. LAW. XXX (2019) (forthcoming, available at https://corpgov.law.harvard.edu/2019/03/26/board-3-0-an-introduction/). In Gilson and Gordon's new more utopian governance environment, "thickly informed, well-resourced, and highly motivated directors would "credibly monitor managerial strategy and operational skill in cases where this would be particularly valuable… and where appropriate could help credibly defend management against shareholder activist incursions when institutional investors are challenged to determine whether company underperformance results from market myopia or from management hyperopia. Similarly, such directors could

In particular, market forces, as distinct from legal duties, appear to be forcing managers of public companies to single-mindedly pursue the goal of wealth maximization.[74] Recently, for example, Ron Gilson and Jeff Gordon have argued that markets have become significantly more efficient at monitoring corporate management and maximizing the performance of investments because this work has been divided between two types of specialist investors: (1) activist investors such as hedge funds who are "governance entrepreneurs"[75] that specialize in monitoring portfolio company strategy and formulating alternatives when appropriate for presentation to the institutional investors; and (2) institutional investors such as mutual funds who specialize in portfolio management and in evaluating proposals presented by the first type of specialists, the activist investors.[76] Gilson and Gordon maintain that this specialization is more efficient than having a single actor act to both develop better strategies for corporations and to manage investment portfolios.[77] And this division increases the value of shareholders' voting rights and serves as a powerful and effective "mechanism for creating value for beneficial owners."[78]

Another complicating aspect of the shareholder wealth maximization myth is that many who recognize (or concede) the mythical nature of the claim that managers must maximize value for shareholders as a matter of law, believe nevertheless that shareholder wealth maximization is at least an important social norm that should be encouraged even if it is unenforceable as a practical matter.[79] But, of course, a norm is not the same thing as a law. Those who believe that shareholders own the firm as a matter of applied property law are highly likely to reason from that starting point that directors are legally compelled to maximize shareholder value. For example, as the Delaware Supreme Court has observed regarding the duties of directors of companies that are spiraling towards bankruptcy, "directors must continue to discharge their fiduciary duties to the corporation and its shareholders by exercising their business judgment in the best interests of the corporation for

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find a place in extremely complex enterprise, such as finance, where the time and expertise demanded of successful directors are high and the costs of business or regulatory failure are profound." *Id*. (also available at https://corpgov.law.harvard.edu/).

[74] Gilson & Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Re-valuation of Governance Rights, supra* note 73, at 897.

[75] *Id*.

[76] *Id*.

[77] *Id*.

[78] *Id. See also id*. at 864 (discussing how the value of shareholders' voting rights has increased, thereby reducing agency costs)"

[79] Mark J. Roe, *The Shareholder Wealth Maximization Norm and Industrial Organization*, 149 U. PENN. L. REV. 2063 (2001) (discussing the relative strength of the shareholder wealth maximization norm in the U.S. and the historical weakness but growing strength of the norm in Continental Europe).

the benefit of its shareholder owners."[80]

To be clear, the argument here is about what the law is perceived to be. It is not an argument about what the law ought to be from a normative or aspirational perspective. And there seems to be no doubt that shareholder wealth maximization is perceived to be the law on the books. As Henry Hansmann and Renier Kraakman pointed out in their influential article, "The End of History for Corporate Law," while there undoubtedly are myriad ways to imagine what the existential purpose of the corporation should be or might be, by the dawn of the twenty-first century, the shareholder-centric view of the corporation has taken the dominant, indeed monopolistic, position in the marketplace of ideas.[81] As Hansmann and Kraakman put it, "[A]cademic, business, and governmental elites" all were in complete agreement "that ultimate control over the corporation should rest with the shareholder class; the managers of the corporation should be charged with the obligation to manage the corporation in the interests of its shareholders; ... and the market value of the publicly traded corporation's shares is the principal measure of the shareholders' interests."[82]

This consensus had strong and definite legal implications. In a world in which the undisputed goal of corporate law was to increase shareholder value, the undisputed role of judges must be to interpret, develop and enforce legal rules that imposed sanctions on corporate actors who engaged in behavior that was inconsistent with the profit maximization goal.[83] To be sure, there were renegades who argued that the corporation should be empowered to serve the public interest rather than the narrow interests of shareholders.[84] Proponents of this approach advocated enabling the

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[80] N. Am. Catholic Educ. Programming Found. Inc. v. Gheewalla, 930 A.2d 92, 101 (Del. 2007). Courts that discuss the duty to maximize shareholder value often assert that there is also a duty to maximize the value of the enterprise itself, for the benefit of the shareholders. *See id.* (pointing out that directors of a firm "comply with their fiduciary duties to the firm by selecting and pursuing with fidelity and prudence a plausible strategy to maximize the firm's value"). *See also* Trenwick Am. Litig. Trust v. Ernst & Young, L.L.P., 906 A.2d 168, 204 (Del. Ch. 2006), *aff'd,* 931 A.2d 438 (Del. 2007) ("Even when the company is insolvent, the board may pursue, in good faith, strategies to maximize the value of the firm."); Richard P. Bartlett III, *Shareholder Wealth Maximization as Means to an End*, 38 SEATTLE U. L. REV. 255, 256 (2015) (arguing that the goal of maximizing value for shareholders will sometimes require corporate management to engage in "the type of reckless, go-for-broke gambles known to plague leveraged firms nearing financial distress and commonly associated with the lead up to the 2008 financial crisis.).

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

[82] *Id*. at 440-441.

[83] *Id*. at 439.

[84] Margaret Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 248-328 (1999); Ronald M. Green, *Shareholders as Stakeholders: Changing Metaphors of Corporate Gover*nance, 5 WASH. & LEE L. REV. 1409, 1411-12 (1993).

corporation to act in the public interest by authorizing corporate directors to act for the benefit of non-shareholder constituencies (affectionately known as stakeholders[85], such as workers, local communities, suppliers and customers) whenever they were inclined to do so.[86] There were even statutory initiatives to provide corporate boards of directors with either the power or the duty to prefer the interests of these non-shareholder constituencies over the interests of shareholders.[87]

Ultimately, the shareholder wealth maximization prevailed. Delaware and states that followed the Model Business Corporation Act expressly declined to depart even rhetorically from the shareholder wealth maximization norm.[88] And in virtually all of the states in which non-shareholder constituency statutes were enacted, they were merely permissive, rather than mandatory, in that they provided only that directors "may," at their discretion include the interests of non-shareholder constituencies in their decision-making. Thus, these statutes did not purport to limit directors' power. To the extent that these statutes had any effect at all on corporate governance, they expanded rather than contracted directorial power by giving directors broader freedom to operate without challenge. Ultimately, however, these statutes were interpreted to mean that the interests of non-shareholder constituencies could only be considered by directors and management to the extent that any actions taken did not conflict with the obligation to maximize value for shareholders. As usual, the definitive word came from Delaware which explained that directors' attention to non-shareholder constituencies worked like this:

> [B]y increasing the value of the corporation, the directors increase the share of value available for the residual claimants. Judicial opinions therefore often refer to directors owing fiduciary duties "to the

[85] The term "stakeholder" is used by proponents of expanding the scope of corporate fiduciary duties to include both non-shareholders as well as shareholders. Those who are hostile to the idea of expanding legal duties beyond a company's shareholder population appear to prefer the term "nonshareholder constituents" to the term "stakeholder" because using the term "stakeholder" 'would concede much of the battle before it has been joined. Describing someone as a stakeholder implies that they have a stake in the firm, which may imply that they have claims on the firm that the firm is legally or morally bound to respect. In contrast, to be a constituent as I use it here means only that one is a component part of the greater Whole, which does not carry the same connotations." Bainbridge, *supra* note 43, at 1425.

[86] *See* The Committee on Corp. Laws of the Am. Bar Ass'n, *Other Constituencies Statutes: Potential for Confusion*, 45 BUS. LAW. 2253-2271 (1990).

[87] *Id*.

[88] Bainbridge, *In Defense of the Shareholder Wealth Maximization Norm: A Reply to Professor Green, supra* note 43, at 1425.

> corporation and its shareholders." This formulation captures the foundational relationship in which directors owe duties to the corporation for the ultimate benefit of the entity's residual claimants. Nevertheless, "stockholders' best interest must always, within legal limits, be the end. Other constituencies may be considered only instrumentally to advance that end."[89]

When articulating the applicable law, the iconic citation is the decision of the Michigan Supreme Court in Dodge v. Ford Motor Co. which characterized the nature and content of corporate law as emanating from the premise that:

> A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end, and does not extend to a change in the end itself, to the reduction of profits, or to the non-distribution of profits among stockholders in order to devote them to other purposes.[90]

Thus, what exists in the U.S. law is, as J. Professor Haskell Murray elegantly has described a "*persistent common perception … that directorial duties require placing shareholder wealth at the forefront*."[91] This perception is driven by court opinions, academic articles, the instructions provided in law schools and business schools, and the popular media.[92] The perception that shareholder wealth maximization is the law of the land is "widely recognized and influential."[93] As Professor Joan MacLeod Heminway aptly observes, this perception:

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[89] In re Trados Inc. S'holder Litig., 73 A.3d 17, 36–37 (Del. Ch. 2013) (Vice Chancellor Travis Laster, citations omitted).

[90] Dodge v. Ford Motor Co., 170 N.W. 668, 684 (Mich. 1919). A number of other cases frequently are cited in support of the proposition that shareholder wealth maximization is the law of the land. *See* eBay Domestic Holdings, Inc. v. Newmark 16 A.3d 1 (Del. Ch. 2010); Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc. 506 A.2d 173 (Del. 1986); and Katz v. Oak Industries Inc., 508 A.2d 873 (Del. 1986).

[91] J. Haskell Murray, *Choose Your Own Master: Social Enterprise, Certifications, and Benefit Corporation Statutes*, 2 AM. U. BUS. L. REV. 1, 17–18 (2012).

[92] *Id*. (The perception that U.S. law requires that corporate actors adhere to a policy and practice of shareholder wealth maximization "may stem from the pronouncements of courts in Dodge and eBay, from various academic articles, from education in business and law schools, and from the popular media.").

[93] *Id*.

> influences the practice of corporate law in very direct ways. Of course, it impacts the advice that a lawyer gives to a corporate client when the client's board is meeting to engage in decision making or oversight. But a shareholder wealth maximization norm also impacts choice of entity, corporate formation, and legal counsel on potential amendments to corporate organic documents—most especially corporate charters.[94]

What Professor Murray and Professor Heminway characterize as perception, I characterize as myth. I prefer to think of the shareholder wealth maximization rule as a myth both because myths are generally inaccurate, while perceptions sometimes are apt, and because like most myths, the belief that the law requires shareholder wealth maximization reflects a deeply held cultural belief and practice.[95] In either case, as shown below, the reality differs from the perception and the myth.

Not only do elites have the ability to drive myths in the corporate arena, they also have the ability to alter them. Despite the pervasive nature of the myth of shareholder maximization in corporate law, the Business Roundtable[96] has recently sought to reshape the myth. On August 19, 2019, the Business Roundtable issued a new "Statement on the Purpose of a Corporation" which articulated the intention of 181 CEOs to move away from shareholder primacy toward "a fundamental commitment to *all . . . stakeholders*," including customers, employees, suppliers, communities, and shareholders.[97] Some have posited that this change[98] constitutes a reaction to

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[94] Joan MacLeod Heminway, *Shareholder Wealth Maximization as a Function of Statutes, Decisional Law, and Organic* Documents, 74 WASH. & LEE L. REV. 939, 956 (2017).

[95] Bernard S. Sharfman, *Shareholder Wealth Maximization and Its Implementation Under Corporate Law*, 66 FLA. L. REV. 389, 393–99 (2014) (describing shareholder wealth maximization as an attainable objective of corporate law).

[96] The Business Roundtable is composed of nearly 200 "chief executive officers of America's leading companies" who advance public policy in the United States. *About Us*, BUSINESS ROUNDTABLE, https://www.businessroundtable.org/about-us (last visited Sept. 28, 2019).

[97] *Our Commitment*, BUS. ROUNDTABLE, https://opportunity.businessroundtable.org/ourcommitment/ (last visited Sept. 28, 2019) (emphasis added).

[98] "Since 1978, Business Roundtable has periodically issued Principles of Corporate

growing political and social hostility toward capitalism in the United States.[99]

B. The Reality

The reality is that directors essentially can do whatever they want, (subject to the subterfuge condition and the qualification that directors refrain from actively damaging shareholders' interests described above. As Bernard Sharfman has observed, courts have "historically shown little interest in reviewing a board decision to determine if shareholder wealth maximization was actually the board's objective" when reviewing corporate decisions.[100]

As many others have observed,[101] understanding the nature and function of the business judgment rule is the key to understanding why the notion of shareholder wealth maximization is a norm and not an enforceable legal principle. Unless directors are actually stealing from the corporation, in order to be actionable, conduct that ostensibly constitutes a failure to maximize profits for shareholders must be shown to violate the fiduciary duty of care. The business judgment rule is a strong evidentiary presumption that whenever a decision of directors is challenged as being inconsistent with the requirement of shareholder wealth maximization, the defendants are entitled to a strong presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interest of the company.[102]

Put simply, efforts to enforce a legal duty to maximize profits for shareholders founders on the shoals of two strongly conflicting legal principles: (1) the principle of democratic legitimacy; and (2) the principle

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Governance. Each version of the document issued since 1997 has endorsed principles of shareholder primacy – that corporations exist principally to serve shareholders." *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.

[99] *See* David Gelles & David Yaffee-Bellany, *Shareholder Value Is No Longer Everything, Top C.E.O.s Say*, N.Y. TIMES (Aug. 19, 2019), https://www.nytimes.com/2019/08/19/business/business-roundtable-ceos-corporations.html ("The shift comes at a moment of increasing distress in corporate America, as big companies face mounting global discontent over income inequality, harmful products and poor working conditions."); Allan Murray, *America's CEOs Seek a New Purpose for the Corporation*, FORTUNE (Aug. 19, 2019), https://fortune.com/longform/business-roundtable-ceos-corporations-purpose/ ("Capitalism, at least the kind practiced by large global corporations, was under assault from all sides, and CEOs were getting the message loud and clear.").

[100] Sharfman, supra note 95, at 392.

[101] *Id*. at 398 ("in most cases the business judgment rule can nullify the fiduciary duty of care.").

[102] Aronson v. Lewis, 473 A.2d 805 (Del. 1984) (*overruled* in other respects by Brehm v. Eisner, 746 A.2d 244 (Del. 2000)).

that corporate decision-making involves specialized skills for which the division of labor is necessary to achieve efficient results. The first principle is that directors are elected, and judicial interference with the corporate strategies and tactics that directors choose necessarily requires unelected judges to substitute their own views of what is best for shareholders for the views of the shareholders' actual, legitimate and democratically elected representatives.

Second, judges, even in Delaware, do not pretend to be experts in business. They are experts in corporate law and corporate governance, and they have serious doubts about their basic capacity to identify whether a particular corporate decision actually furthered the interests of shareholders or not.[103] For better or worse, directors are considered by courts to be business experts and they often are. Judges go to such great lengths to defer to directors decisions that the shareholder wealth maximization norm is for all intents and purposes a complete nullity. In a world that is in constant flux, it is worth noting that the succinct observation made by Joseph Bishop in 1968 about the failure to enforce rules requiring maximizing shareholder value are every bit as true today as they were then: "The search for cases in which directors of industrial corporations have been held liable in derivative suits for negligence uncomplicated by self-dealing is a search for a very small number of needles in a very large haystack.'"[104]

C. The Rationale Underlying the Myth: Where are the Emperor's Clothes? Rights of shareholders virtually nonexistent w/o myth, who would invest.

It is easy to show that the idea of a legal duty to maximize shareholder profits is a myth,[105] and explaining the role played by this myth is not much more difficult. Because the principle of shareholder wealth maximization is characterized as a legal principle, corporate actors believe that they should

[103] *See* Kamin v. American Express Co., 383 N.Y.S.2d 807, 812–13 (N.Y. Sup. Ct. 1976) (The directors' room rather than the courtroom is the appropriate forum for thrashing out purely business questions which will have an impact on profits, market prices, competitive situations, or tax advantages"); Shlensky v.Wrigley, infra, (refusing to interfere with a patently bad board decision to refuse to install lights in Wrigley Field to enable baseball games to be played at night, and observing that night play, "[W]e do not mean to say that we have decided that the decision of the directors was a correct one. That is beyond our jurisdiction and ability." 237 N.E.2d 776, 780 (1968). *See also* Stephen M. Bainbridge, *The Business Judgment Rule as Abstention Doctrine*, 57 VAND. L. REV. 83, 109 (2004).

[104] Joseph Bishop, *Sitting Ducks and Decoy Ducks: New Trends in the Indemnification of Corporate Directors and Officers*, 77 YALE L.J. 1078, 1099 (1968).

[105] STOUT, *supra* note 23, at 25.

and must comply with it. In other words, the role of myth here is to channel behavior. By calling shareholder wealth maximization a law, we make it more likely that corporate officers and directors will strive to comply with it. In other words, the false characterization of the shareholder wealth maximization ideal as a law has the practical effect of transforming the status of shareholder wealth maximization from that of a mere norm into that of a "super norm." Violating a norm can subject someone to social disapproval and possible embarrassment, or even social exclusion. Violating the shareholder wealth maximization super-norm can lead to complete ostracism from the corporate world. And, while an officer or director cannot be prosecuted criminally or even sued civilly for violating the shareholder wealth maximization norm, violating this norm risks being characterized as a miscreant and even as a criminal.

The myth of shareholder wealth maximization appears to be highly successful in shaping the views of managers. A survey of senior managers of public companies showed stark differences in the views of top managers about shareholder primacy.[106] Senior managers of corporations in France, German, Japan, the U.K. and the U.S. were asked to choose their preferred response from these two alternatives:

> (a) Whether "a company exists for the interest of all stakeholders" or
> (b) Whether "shareholders' interest should be given the first priority."
>
> and
>
> (a) Whether "executives should maintain dividend payments, even if they must lay off a number of employees" or
> (b) Whether "executives should maintain stable employment, even if they must reduce dividends".[107]

As the following chart shows, senior managers in the U.S. and U.K., where the shareholder primacy myth is prevalent were strongly of the view that the corporation belonged to the shareholders, and that dividends for shareholders were more important than job security for workers. In fact, almost 90 percent of US managers found dividends more important than job

[106] Franklin Allen & Douglas Gale, *Corporate Governance and Competition*, Chapter 2 *in* CORPORATE GOVERNANCE: THEORETICAL AND EMPIRICAL PERSPECTIVES, (Xavier Vives ed., Cambridge U. Press: Cambridge, U.K.) (2000), Figures 2 and 3, *citing* Masaru Yoshimori, *Whose Company Is It? The Concept of the Corporation in Japan and the West in* LONG RANGE PLANNING, Vol. 28, No. 4, 33-44 (1995), Inst. of Fiscal and Monetary Pol'y (1996), Chart III-1-2, p. 57. (Number of firms surveyed: Japan, 68; United States, 82; United Kingdom, 78; Germany, 100; France, 50).

[107] *Id*.

security, compared with only 2.9% of Japanese managers. Similarly, virtually all (97.1 percent) of Japanese managers thought that that the corporation belonged to all of the stakeholders, while less than one-third (29.5 percent) of U.S. managers took this position, with the vast majority (75.6 percent) of U.S. managers holding the view that the corporation belonged to the shareholders. This survey data strongly supports the conclusion that myths can have a powerful effect on managerial perspectives.

Differences in Perspectives on Corporate Governance: Preferences of Senior Managers about Corporate Objectives						
Survey question	**Possible Answers**	**Japan**	**Germany**	**France**	**USA**	**UK**
(1) Whose Company is it?	All stakeholders Only shareholders	97.1 2.9	82.7 17.3	78 22	24.4 75.6	29.5 70.5
(1) No. of respondents:		68	110	50	82	78
(2) Which is more important?	Job Security Dividends	97.1 2.9	59.1 40.9	60.4 39.6	10.8 89.2	10.7 89.3
(2) No. of respondents:		68	105	68	83	75

Finally, as I have observed previously, a critical role served by the shareholder wealth maximization myth is that it serves as a useful guide for evaluating the performance of corporate management.[108] If corporate directors and corporate managers stop believing in the myth that they are supposed to maximize value for shareholders, there would be precious little, if anything to constrain them from simply pursuing their own, idiosyncratic notions of what is "best" for whatever group of corporate constituents they idiosyncratically and serendipitously happened to prefer at a particular moment in time.

V. The Myth that Corporate Law Requires Companies to be Kept Separate from their Subsidiaries

It is well known that a central motivation for establishing a corporation or limited liability company is to compartmentalize liability. Piercing the corporate veil is a legal remedy that sometimes enables the tort and contract creditors of various forms of limited liability business organizations to look beyond the assets of the corporation (or other business organization) and seek payment of their claims from assets that belong to equity investors in the corporation such as shareholders. This Section of the Article shows that law of piercing the corporate veil mythologizes the relationship between controlling shareholders and the corporations in which they own shares. The myth inherent in the law of piercing the corporate veil

[108] Jonathan R. Macey, *Sublime Myths: An Essay in Honor of the Shareholder Value Myth and the Tooth Fairy*, 91 TEXAS L. REV. 911 (2013).

is particularly fantastic in its conception of the relationship between parent corporations and their subsidiaries.

The myth of the law concerning piercing the corporate veil is both descriptive and normative. The descriptive claim is that shareholders – even shareholders who own or control 100 percent of the shares of a company -- do not dominate, control and manage such companies. The normative claim is that - even though large shareholders have the power to dominate, control and manage the corporations in which they have invested – for some reason it is contrary to public policy to permit shareholders to avail themselves of that power.

Because of the gulf between the myth and the reality of corporate separateness, the legal system is not working very well in administering the system of limited liability. The law is vague and uncertain, leading experts to observe that the law is vague and that it is difficult or impossible to predict the outcomes of litigated cases.[109] It is generally thought that "legal doctrine in this area is notoriously incoherent"[110] and that "courts typically base their decisions on conclusory references to criteria of doubtful relevance."[111] Strong evidence of the fact that the law of piercing the corporate veil is in a state of confusion is the fact that veil piercing is the most heavily litigated issue in corporate law.[112] Where the law is clear, potential litigants will

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[109] ROBERT CHARLES CLARK, CORPORATE LAW § 2.1, at 38 (1986) ("Do you notice anything intellectually disturbing about this [standard piercing-the-corporate-veil] formulation? That's right; it's vague. It hardly gives you any concrete idea about which conduct does or does not trigger the doctrine-not enough of an idea, at least, to give you the ability to counsel clients in a meaningful way."); ROBERT W. HAMILTON, JONATHAN R. MACEY & DOUGLAS K. MOLL, CASES AND MATERIALS ON CORPORATIONS INCLUDING PARTNERSHIPS AND LIMITED LIABILITY COMPANIES 213 (2010) ("in no other area are courts more prone to decide real life disputes by characterization, epithet, and metaphor: 'alter ego,' 'instrumentality,' 'sham,' 'subterfuge,' or 'tool,' to select a few,"); Jonathan Macey & Joshua Mitts, *Finding Order in the Morass: The Three Real Justifications for Piercing the Corporate Veil*, 100 CORNELL L. REV. 99 (2014) ("Apparently inconsistent with the "limited liability" nature of the corporate enterprise, the list of justifications for piercing the corporate veil is long, imprecise to the point of vagueness, and less than reassuring to investors and other participants in the corporate enterprise interested in knowing with certainty what the limitations are on the scope of shareholders' personal liability for corporate acts. For example, veil piercing may be done where the corporation is the mere "alter ego" of its shareholders; where the corporation is undercapitalized; where there is a failure to observe corporate formalities; or where the corporate form is used to promote fraud, injustice, or illegalities"); David K. Millon, *Piercing the Corporate Veil, Financial Responsibility, and the Limits of Limited Liability*, 56 EMORY L.J. 1305, 1307 (2007) ("[r]esults are unpredictable").

[110] *Id*.

[111] *Id*.

[112] Robert B. Thompson, *Piercing the Veil Within Corporate Groups: Corporate Shareholders as Mere Investors*, 13 CONN. J. INT'L. L. 379, 383 (1999).

estimate accurately what the outcome of proposed litigation will be. And, since litigation is more expensive to both sides than settlement, the capacity accurate to anticipate the outcome will lead both sides to settle, since the two parties can share the savings generated by settling rather than litigating the case.[113] On the other hand, where the law is muddled and confused, there will be more litigation and, since outcomes are unpredictable, there will be a "tendency toward 50 percent plaintiff victories" among litigated cases."[114]

As developed here, the law of piercing the corporate veil is incoherent because of the wide divergence between the view of what constitutes appropriate corporate behavior suggested in certain legal formulations of the law of veil piercing and the actual ordinary and customary business practices that one observes in the real world. The particular focus of the analysis here is on the most difficult and fraught issues in veil piercing law, which are those that arise in the parent-subsidiary context.[115] In light of "the massive financial assets of many multinational parent corporations, actions seeking to ignore the legal separateness of a corporate subsidiary of a parent company offer some of the biggest potential payoffs for claimants."[116] The burgeoning litigation in the parent-subsidiary context appears to account for the high litigation rates in the field of veil piercing.[117] In a nutshell, the myths described here about piercing the corporate veil lead to a legal landscape on which there is a vast gap between the perception that it is easy to pierce the corporate veil in the parent-subsidiary context and the reality, that parent companies are immune from liability from the debts of their subsidiary unless they are found to have abused the corporate form by using it to commit some significant form of wrongdoing, such as fraud.

This section of the Article begins with a review of the economic rationale for limited liability and proceeds to a discussion of the myths associated with the doctrine of piercing the corporate veil. It concludes with a discussion of the reality that the myth seeks to obfuscate.

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[113] George Priest & Benjamin Klein, *The Selection Of Disputes for Litigation*, 13 J. LEGAL STUD. 1–55 (1984); *See also* J.J. Prescott & Kathryn E. Spier, *A Comprehensive Theory of Civil Settlement*, 91 N.Y.U. L. REV. 59–143 (2016); Yoon-Ho Alex Lee & Daniel Klerman, *The Priest-Klein Hypotheses: Proofs and Generality*, 48 INT'L REV. LAW & ECON. 59-76 (2016); George Priest, *Selective Characteristics of Litigatio*n, 9 J. LEGAL STUD. 399 (1980); George Priest, *The Common Law Process and the Selection of Efficient Rules*, 6 J. LEGAL STUD. 65 (1977).

[114] Priest & Klein, *supra* note 109, at 18.

[115] STEPHEN B. PRESSER, PIERCING THE CORPORATE VEIL § 1:7, at 1-45 (1991) ("A sizable and increasing body of literature suggesting that the real focus of the piercing problem is in the area of parent and subsidiary law.").

[116] John H. Matheson, *The Modern Law of Corporate Groups: An Empirical Study of Piercing the Corporate Veil in the Parent-Subsidiary Context*, 87 N. CAROLINA L. REV. 1092, 1095 (2009).

[117] *Id.* at 1095.

A. The Economics of Limited Liability

Perhaps the most important concept in private law is the concept of limited liability, which has been characterized as "the greatest single discovery of modem times…. Even steam and electricity are far less important than the limited liability corporation, and they would be reduced to comparative unimportance without it."[118] The corporate form permits investors in corporations to manage their risk through the operation of what is known as "limited liability." Limited liability is the concept that the ceiling on shareholders' risk of loss associated with their investments is limited to the amount of those investments.

From an economic perspective, limited liability provides incentives for investors to invest in wealth producing businesses that generate growth and employment because they can invest without the risk that all of their assets will be exposed to loss for tort or contractual liabilities incurred by the corporations in which in their investments have been made.

The justification for limited liability can be more completely described as justifying the using the corporate form as a liability shield in order: (a) to encourage investment; (b) to promote the economic efficient operation of separately incorporated businesses; and (c) to allow investors to form, invest in and manage multiple businesses. These economic justifications for piercing the corporate veil apply with equal force to all investors, regardless of whether the investor is an individual who owns a very small percentage of the stock in a corporation or whether the investor is itself a corporation and owns 100% of the shares of many companies.

In order to achieve the economic benefits of the corporate form, the liability of investors, including parent corporations and affiliated corporations must be limited to the amount of their capital investments.

The ability of investors and companies to isolate liability within separately incorporated businesses (even under a single umbrella) enables them to pursue investment opportunities that have a positive present value benefits for employees, local communities, investors and others by encouraging investment. In sum, the rationale for limited liability is to encourage investment. This important economic objective can only be achieved if investors have a reasonable degree of certainty that when they

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[118] Nicholas Murray Butler, *Why Should We Change Our Form of Government?,* 82 (1912). https://archive.org/details/whyshouldwechan00butlgoog/page/n102 (accessed May 9, 2019). Nicholas Butler was president of Columbia University, president of the Carnegie Endowment for International Peace, and a recipient of the Nobel Peace Prize in 1931. *See* The Nobel Prize Organization, *Nicholas Murray Butler*, https://www.nobelprize.org/prizes/peace/1931/butler/facts/ (accessed May 9, 2019).

make an investment they do not risk becoming personally and unlimitedly liable for the debts of the businesses in which they have invested.

From an economic perspective, limited liability allows business enterprises to aggregate the large amounts of capital that are often necessary to fund their operations from investors who would be unwilling to risk the entire corpus of their personal wealth in a risky business enterprise. Economists have observed that the expected cost of even a remote risk of a catastrophic loss will outweigh the prospective gains in many, if not most potential investments.[119] Thus, absent limited liability, a substantial portion of the investment in business that we observe would not occur. Limited liability also facilitates the capital formation process by investors to assemble diversified portfolios of stock and other assets. Such diversification reduces the risk of holding financial assets such as stock, and further facilitates capital formation and the funding of new and existing businesses.

In addition, through holding companies and parent-subsidiary relationships, limited liability promotes the economic efficient operation of separately incorporated businesses. Parent companies can own controlling interests in multiple subsidiaries that are involved in business activities that have different risk and return profiles. Each can be managed according to its own particular requirements and needs, with cost savings generated by sharing access to capital markets and technical expertise between and among the various entities in the group. Finally, limited liability enables investors to form, invest in and manage multiple businesses simultaneously. This permits entrepreneurs and managers to leverage their expertise and human capital resources across multiple enterprises.

B. The Myths Regarding Control and Management

The role of myths in piercing the corporate veil law is easy to describe. The myths begin with a factual description of the parent subsidiary relationship, move to a description of the benign, ordinary and customary manner in which parent companies operate their subsidiaries, and then claim that this relationship and manner of operating a subsidiary provides a justifiable legal basis for piercing the corporate veil. The extreme version of this myth is that ownership or a so-called controlling block of shares is sufficient to justify piercing the corporate veil and holding a parent company responsible for the debts of a subsidiary. However, this simply cannot be the case, because if it were, then the legal concept of limited liability could not exist in the parent-subsidiary context, because, by definition, all parent companies own a controlling block of shares in their subsidiaries.

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[119] FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 44 (1991).

Another, slightly less absurd (though equally fallacious) version of the myth is that proper corporate governance requires that parent companies operate their subsidiaries in a manner that is wholly independent of the operations of both the parent corporation and the subsidiaries' affiliates.[120] It is erroneously thought that it is illegal or improper for a parent company to "dominate" a subsidiary. This mistaken hypothesis has led to a litigation environment in which the issue of whether a parent company dominates its subsidiary, "is the most frequently addressed issue in piercing cases."[121]

A similar myth in the law of piercing the corporate veil is that it is improper and even tortious for a parent company to be significantly involved in the corporate governance of a subsidiary.[122] The myth is that the ability of a parent to control its subsidiary, either alone or couple with the economic and functional integration of the parent and the subsidiary are enough in the parent-subsidiary context to justify a determination to pierce the corporate veil.[123]

In essence, veil piercing claims are assertions that the separate legal status of a corporation or LLC should be disregarded. Such claims typically are supported by specific allegations or examples of what are alleged in a conclusory manner to be improper control over a subsidiary and failure to maintain the separate corporate identities of the companies.[124] In fact, subsidiary companies *inevitably* lack independence from their parents and unavoidably are dominated by their subsidiaries.[125] Such control and domination is inevitable because, *by definition*, a parent company is a company that has a controlling block of shares in one or more other companies. The companies that are owned and controlled are *defined* as subsidiaries.[126]

Subsidiaries' lack of independence and its corollary, their parent companies' domination of them, is inevitable - and desirable - because parent companies themselves have shareholders, and parent companies owe

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[120] In this context, the term "affiliate" means a company that controls, is controlled by, or is under the common control of a second company.

[121] *Id*. at 1125.

[122] Nina A. Mendelson, *A Control-Based Approach to Shareholder Liability for Corporate Torts*, 102 COLUM. L. REV. 1203, 1271-79 (2002) (espousing unlimited liability for torts in the parent subsidiary context).

[123] *Id*.

[124] Macey & Mitts*, supra* note 105.

[125] Matheson, *supra* note 112*,* at 1125.

[126] Corporate Finance Institute, *What is a Subsidiary?,* https://corporatefinanceinstitute.com/resources/knowledge/finance/subsidiary-definition/ ("A subsidiary (sub) is a business entity or corporation that is fully owned or partially controlled by another company, termed as the parent, or holding, company. Ownership is determined by the percentage of shares held by the parent company, and that ownership stake must at least 51%.").

fiduciary duties to those shareholders which require them to be attentive stewards of their investments in their subsidiaries. Further, parents' involvement in the activities of their subsidiaries is desirable, because it is highly efficient. Parent companies can efficiently reduce risk by having multiple subsidiaries engaged in different lines of business or in the same line of business in different geographical regions. By providing shared services to these multiple subsidiaries, the benefits of the reduction in risk associated with operating through subsidiary companies can be attained with less loss of operational efficiency.

C. The Reality

The source of the confusion is easy to identify. As an empirical fact, where a court finds that a parent dominated its subsidiary, it will pierce the corporate veil and find the parent liable for the tort and contractual obligations of the subsidiary. In contrast, where a court fails to find that a parent dominated its subsidiary,[127] it will almost always decline to pierce the corporate veil. Specifically, in cases where the courts determined that control or dominance was present, piercing occurred 82.0% … of the time.[128] And, where a court determined that dominance was not present, piercing occurred very rarely, in only 2.1% of cases.[129] In other words, "if no control or dominance was found, the courts almost literally refused to pierce the corporate veil, absolving the parent from liability in 97.9% of the cases."[130] In fact, piercing the corporate veil in parent-subsidiary cases occurs even less frequently than piercing the corporate veil occurs generally in litigation.[131]

This data appears to explain why plaintiffs sue so often in parent subsidiary cases alleging that the parent dominated its subsidiary. What appears to be less understood is the counterintuitive reality that courts seldom determine that the parental control or dominance necessary to imposing liability actually exists.[132] It is not surprising that plaintiffs fail to grasp this fact. As John Matheson has cogently observed:

> As a simple matter of first appearances, this

[127] Because the burden of proof in piercing cases rests with the plaintiff, a defendant parent corporation need not sustain the burden of proving the negative case that it did not dominate the subsidiary.

[128] Matheson, *supra* note 112, at 1125.

[129] *Id*. at 1125.

[130] *Id*. at 1153.

[131] Peter B. Oh, *Veil-Piercing*, 89 TEX. L. REV. 81 (2010) (Veil-piercing between parent and subsidiary occurs less frequently in the parent-subsidiary context than in the context of an individual suing a closely held corporation).

[132] Matheson, *supra* note 112, at 1125.

> infrequent judicial finding of control or dominance seems counterintuitive. A parent who owns 100% of the shares of a subsidiary company admittedly "controls" and "dominates" the subsidiary in any usual sense of those terms. The parent, as sole shareholder, elects the board of directors of the subsidiary (and can remove any of those directors), which is the policy-making organ of the corporation. The chosen board then selects the subsidiary's officers and managers. The parent initiates, directly or through the board, and must as shareholder approve any fundamental corporate or policy changes in the subsidiary's operations. The parent is the sole beneficiary of the productivity and profits of the subsidiary's operating results. This is control or dominance in the normal sense of those terms and exists automatically and tautologically in the parent-subsidiary situation.[133]

Summarizing, there is a myth that it is easy to pierce the corporate veil in the parent subsidiary context because of an alleged ubiquitous domination and control of parent companies over their subsidiaries, and because parent companies do not maintain a sufficient degree of corporate separateness between themselves and their subsidiaries. In point of fact, however, as recent empirical work has shown, "there is a clear reluctance of courts to hold the parent liable for the acts of the subsidiary barring some fraud/misrepresentation or some truly extraordinary and excessive parental control or dominance."[134]

The reality is that holding companies normally and necessarily are involved in the activities of their subsidiaries because they are the stewards of their investments in these businesses. A parent's involvement in the activities of its subsidiaries does not undermine the commercial principle – universally understood in the business world – that affiliates are distinct and separate entities from each other. Rather, such involvement is both appropriate and necessary. It is common for parent companies to directly or indirectly provide shared services such as insurance procurement, cash management, accounting, legal, technical, environmental, and to charge for such services.[135] It's done for efficiency reasons, and helps profitability and economic efficiencies, and economies of scale. It is well known in the world

[133] *Id*.
[134] *Id*.
[135] *See* Fletcher v. Atex, Inc., 68 F.3d 1451 (2d Cir. 1995).

of mergers and acquisitions, for example, that every acquisition, by definition brings the company that is the target of the acquisition "under the control" of the acquirer. Such control, manifested by the acquirer's' share ownership, does not by itself imply or suggest that the acquirer automatically becomes responsible for the debts of the target. Every controlling shareholder (whether shares are held individually or by a corporation) has the power to control the company that they own. This is what it means to be a controlling shareholder.

It is common business practice for parent companies to control the capital expenditures of their subsidiaries. In particular, it is common for parent companies and controlling shareholders to approve leases, major capital expenditures, large investments, major policy decisions and sales of securities.

Capital expenditures represent investments in a business that are expected to generate revenue over a longer period of time (i.e., a period of time in excess of a single tax year). Capital expenditures are expenditures on assets such as new buildings or equipment or patents, as well as upgrades to existing facilities. In contrast, operating expenses are those incurred in the ordinary day-to-day operation of a business. Expenditures on maintenance, repairs, utilities and workers' wages are examples of operational expenses. The tax and financial reporting treatment of capital and operational expenditures is different. The approval by a parent company of the capital expenditures of a subsidiary is consistent with ordinary and customary practice in the corporate world.

Far from the myth that control over a subsidiary serves as a justification for piercing the corporate veil, the control that holding companies and other corporate parent companies typically exert over their subsidiaries is both desirable and necessary. When a corporation has a controlling interest in another corporation, that (parent) corporation will have investors of its own. As a matter of basic business practice, a parent company must work to maximize the value of the subsidiary in order to generate a competitive return for its own shareholders. Similarly, parent companies generally are required to produce consolidated financial statements and tax returns that reflect the results of their subsidiaries. In order to do this, parents must be able to control the financial reporting of their subsidiaries in order to be sure that the results are reported accurately and in the proper format. Similarly, it is ordinary and customary for parent corporations to retain veto power over subsidiaries or to require that subsidiaries obtain the prior approval of the parent for various actions. Of course, it is common for parent companies to retain documents and records related to the subsidiary.

As a matter of ordinary and customary corporate practice, parent companies require information from, engage in ongoing monitoring of, and are closely involved in the activities of their subsidiaries for at least three reasons. First, because parent companies have their own investors, such parent companies have a responsibility to serve as effective stewards of their sizeable investments in their subsidiaries. Second, because subsidiaries' financial results generally are combined with the results of the parent company and other affiliates for SEC reporting and tax purposes, parent companies must have up-to-date and accurate information about the subsidiaries in order to be able to make timely and accurate disclosures and filings. Third, under statutes such as the Sarbanes-Oxley Act ("SOX") and the Foreign Corrupt Practices Act ("FCPA"),[136] parent companies may be liable for a subsidiary's breaches of the Act, even if the parent had no knowledge of it and parental "control" of the subsidiary consisted only of relatively common connections between a parent and a subsidiary.

The Sarbanes-Oxley Act,[137] passed in 2002, reflects the most major incursion by the federal government into the realm of the internal corporate governance of U.S. companies in history.[138] SOX does not distinguish between subsidiaries and parents.[139] Under SOX, all public companies are required to submit an annual assessment of the effectiveness of their internal financial auditing controls to the Securities and Exchange Commission (SEC).[140] Additionally, each company's external auditors are required to

[136] Foreign Corrupt Practices Act of 1977, Pub. L. No. 95-213, 91 Stat. 1494, codified as amended in scattered sections of 15 U.S.C.

[137] The Sarbanes–Oxley Act of 2002 (Pub. L. 107–204, 116 Stat. 745, codified at various sections of 15 and 18 U.S.C., enacted July 30, 2002 more commonly called Sarbanes–Oxley, Sarbox or "SOX."

[138] Roberta Romano, *The Sarbanes-Oxley Act and the Making of Quack Corporate Governance,* 114 YALE L.J. 1521, 1527 (2005) ("The substantive corporate governance provisions overstep the traditional division between federal and state jurisdiction."). *See id.* at 1523 (Until SOX was passed, the "federal regime had until then consisted primarily of disclosure requirements rather than substantive corporate governance mandates, which were traditionally left to state corporate law. Federal courts had, moreover, enforced such a view of the regime's strictures, by characterizing efforts of the SEC to extend its domain into substantive corporate governance as beyond its jurisdiction. SOX alters this division of authority by providing explicit legislative directives for SEC regulation of what was previously perceived as the states' exclusive jurisdiction.")

[139] SOX applies to all publicly traded companies in the United States as well as to the wholly-owned subsidiaries of such companies and to foreign companies that are publicly traded and do business in the United States. Further, the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203 (signed July 21, 2010) ("Dodd-Frank" or "Act"), amended and clarified SOX, so as to expressly provided that SOX whistleblower protections are available to the employees of non-public subsidiaries of publicly-traded companies, so long as those subsidiaries' financial information is included in the consolidated financial statements of the publicly-traded parent companies. Dodd-Frank Sec. 929A, amending 18 U.S.C. § 1514A (a).

[140] Romano, *supra* note 134, at 1527. The principal substantive corporate provisions of SOX require the forfeiture of certain executive compensation in the event of a material

audit and report on the internal control reports of management, in addition to the company's financial statements. As this statute applies both to public companies and to their subsidiaries, SOX effectively requires a significant amount of parental control over subsidiaries. As Roberta Romano has observed:

> Section 302 of SOX requires the CEO and CFO to certify that the company's periodic reports do not contain material misstatements or omissions and "fairly present" the firm's financial condition and the results of operations. The certification requirement contains substantive corporate governance mandates. It imposes on the signing officers the responsibility for establishing and maintaining internal controls and for evaluating the effectiveness of those controls, along with the duty to disclose to the audit committee any deficiencies in the internal control design or any fraud involving any officer or employee with a significant role in the company's internal controls. The officers' signature certifies both the undertaking of those tasks and the veracity of the financial information. Section 404 contains a related filing requirement, a management report attested to by the external auditor assessing the internal controls. A third provision, section 906(a), is a new criminal statute that enumerates penalties for knowingly violating a certification requirement similar to that of section 302.[141]

Similarly, likely influenced strongly by the requirements in SOX that directors of parent companies monitor and control the financial reporting of their subsidiaries, it "generally is understood" that the duties of good faith that directors of US corporations owe to the corporation and its shareholders "*include a duty to oversee the operations of the corporation's*

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restatement of the company's financial statements, that companies have independent audit committees, restrict corporations' purchases of non-auditing services from their auditors, prohibit corporate loans to officers, and, most importantly, require executive certification of financial statements. SOX, Pub. L. No. 107-204, § 304, 2002 U.S.C.C.A.N. (116 Stat.) 745, 778 (15 U.S.C. § 7243) (executive compensation).

[141] Romano, *supra* note 134, at 1540, *citing* SOX, Pub. L. No. 107-204, § 302, 2002 U.S.C.C.A.N. (116 Stat.) 745, 777-78 (15 U.S.C. § 7241). § 404, 2002 U.S.C.C.A.N. (116 Stat.) at 789 15 U.S.C. § 7262); § 906(a), 2002 U.S.C.C.A.N. (116 Stat.) at 806 (15 U.S.C. § 1350).

subsidiaries."[142]

For example, in *In re Puda Coal,* the Delaware Chancery Court made clear that directors have significant obligations to oversee their subsidiaries, even if those subsidiaries are located in foreign countries, and have their own boards of directors. The court's basic observation was that directors with substantial foreign subsidiaries or assets simply could not "sit in [their] home in the US and do a conference call four times a year and discharge [their] duty of loyalty." The court "implied that corporations with substantial or important foreign subsidiaries or assets should be held to a higher oversight standard."[143] In *Puda Coal*, the Delaware court determined that directors of a parent company whose assets are invested substantially in a subsidiary must sometimes take substantial steps in order to meet their fiduciary duty of good faith. In particular, the court instructed parent company directors that, "if you're going to have a company domiciled for purposes of its relations with its investors in Delaware and the assets and operations of that company are situated in China that, in order for you to meet your obligation of good faith, you better have your physical body in China an awful lot. You better have in place a system of controls to make sure that you know that you actually own the assets. You better have the language skills to navigate the environment in which the company is operating. You better have retained accountants and lawyers who are fit to the task of maintaining a system of controls over a public company."[144]

Similarly, under the FCPA parent companies are encouraged to become actively involved in the operations of their subsidiaries because any parent that fails to implement adequate internal controls to prevent bribery at its subsidiary, or whose books and records are false as a result of mischaracterizing payments such as bribes at its subsidiary, may be held civilly liable under the FCPA's accounting provisions without proof that the parent knew of the bribery.

It also is extremely common for employees to simultaneously perform roles as officers of several corporations within the same corporate group. As a matter of ordinary and customary corporate governance, serving simultaneously in two or more roles within a corporate group is quite common and is known as "double hatting." There is nothing nefarious about

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[142] Cynthia M. Krus & Dwaune L. Dupree, *Subsidiary Oversight - An Evolving Standard of Care for Directors?*, LEXOLOGY (June 4, 2018), https://www.lexology.com/library/detail.aspx?g=04fb1397-02e6-4804-990f-f2482c8a6dd8 (accessed June 25, 2019); also available at https://us.eversheds-sutherland.com/portalresource/lookup/poid/Z1tOl9NPluKPtDNIqLMRV56Pab6TfzcRXncKbDtRr9tObDdEpKJEoS3!/fileUpload.name=/Krus-Dupree.pdf (accessed June 25, 2019).

[143] *Id*.

[144] 2013 WL 769400 (Del. Ch. 2013) (bench ruling), transcript available at: http://www.delawarelitigation.com/files/2013/02/puda-case.pdf, (accessed June 25, 2019).

double-hatting. There are obvious efficiencies in the form of cost-savings associated with the practice. Double hatting also is done to provide an executive with opportunities to learn and gain experience in a variety of roles.

I note that it is ordinary and customary – and indeed unavoidable – for controlling investors to be involved in the management of their businesses to make decisions for those businesses. If a tribunal were to suggest that making decisions indicated liability, then the investor managers in every one of the hundreds of thousands of corporations, partnerships and LLCs with owner/managers would face liability.

From an economic perspective it is efficient for investors and their affiliated companies to monitor and provide managerial input and corporate governance services to their subsidiaries to other companies in which they have invested.

As a matter of ordinary and customary business practice, investors and their affiliates normally and necessarily are involved in the activities of their affiliates because they are the stewards of their investments in these businesses. A person's routine involvement in the activities of its subsidiaries does not undermine the commercial principle -- universally understood in the business world -- that treats affiliates as distinct and separate entities.

It is common for a parent company and its affiliates to provide services to a number of its subsidiaries. These services, which are provided either by the parent or a subsidiary of the parent, are known as shared services when they are offered simultaneously to a number of subsidiaries. Because of their experience in providing certain services, it is efficient for parent companies (or certain specialized subsidiaries of the parent) to provide services for operating subsidiaries. It is common for services like accounting, legal, human resources, payroll, information technology (IT), compliance, purchasing, security, and engineering. The provision of services by a parent is efficient because it reduces the costs of having decentralized business activities, and permits subsidiaries to avail themselves of the experience and expertise of the parent company.

It is customary for a parent company or subsidiary that provides services to a subsidiary to charge for those services. From an economic perspective, where there is a benefit to having a parent company provide a service to the subsidiary, then the parent should be encouraged to provide such a service. For example, where a parent company has particular expertise in technical accounting or regulatory matters, that parent company should be encouraged to provide accounting or regulatory services to its subsidiaries because leveraging this expertise across firms within a corporate group is efficient. Thus, from an economic perspective, it is inefficient to impose liability on a parent for permitting a subsidiary to avail itself of the parent's expertise in various specific issues because the imposition of liability in this context would provide a strong disincentive to parent companies to allow their subsidiaries to avail themselves of a parent's expertise.

A corporate group is a collection of corporations that function as a single economic entity through a common source of control. Parent companies are those companies in the group that own a controlling interest in the shares of other companies in the group. Those companies that operate under common control by one or more parent companies are known as affiliate companies. Companies under common control of the same parent or parent companies are known as affiliates. It is ordinary and customary business practice for companies that are members of the same corporate group to operate as a single entity for financial reporting, tax reporting and other purposes, such as marketing and research and development.

It is common for companies within the same corporate group to use the same stationary, to share marketing programs and to refer to themselves as a single entity, notwithstanding the fact that the corporate group is comprised of a number of distinct legal entities, often incorporated in different jurisdictions. Likewise, parent companies and subsidiary companies that produce the same products may be considered a single entity for antitrust purposes, even when their identities remain distinct for organizational or legal purposes. For example, it is common practice for the multiple subsidiaries of multi-national corporations to conduct business and engage in activities such as research and development (R&D) jointly as integrated global teams. One strategy utilized by multi-national corporations is "to put together an Integrated Network of R&D units—essentially a "virtual organisation" that physically exists in multiple countries but that thinks and acts as an integrated whole. This approach allows for a coherent and structured R&D strategy to emerge, but it gives very limited degrees of freedom to the individual R&D units because they are acting as satellites of the headquarters operation."

Parent companies, particularly large companies often engage in corporate branding across subsidiaries and other related companies as a marketing strategy. In business, the synergies available from having parents and subsidiaries engage in joint marketing arrangements are cited, along with sharing administrative services and financial systems, as a principal advantages of forming subsidiaries in the first place. For example, it is not uncommon for parent companies and subsidiaries and affiliates to share logos, specific letterhead or stationary, common websites, and packaging.

It is common for plaintiffs to argue that the corporate veil of subsidiary companies should be pierced because of public representations by the parent that refer collectively to the parent and its subsidiaries as "our," "us," or "the Company." However, such representations are entirely consistent with ordinary and customary business practice among corporate groups.

For example, in the GE Annual Report for 2016, the company refers to itself as a global company and refers to its joint activities with its subsidiaries as activities by "the company." GE reports in its 10-K that "we also produce and market engines through CFM International, a company jointly owned by GE and Snecma…." Similarly, in its annual report for 2016, the large insurance company AIG uses the terms "AIG," the "Company," we," "us" and "our" to refer to American International Group, Inc., a Delaware corporation, and to its subsidiaries. Likewise, Apple Inc. notes in its annual report that "the 'Company' and 'Apple' as used herein refers collectively to Apple Inc. and its wholly-owned subsidiaries, unless otherwise stated." And Google reports that "throughout this Annual Report on Form 10-K, we refer to Alphabet and its consolidated subsidiaries, including Google and its consolidated subsidiaries, as 'we,' 'us,' and 'our;' Alphabet Inc. and its subsidiaries as 'Alphabet;' and Google Inc. and its subsidiaries as 'Google.'" Similarly, Newmont Mining Corporation, the largest copper mining company in the U.S., refers to itself together with its affiliates and subsidiaries as "Newmont," "the Company," "our" and "we."

In a nutshell, then, the myth, largely attributable to looks language in piercing the corporate veil cases, is that parent companies are removed from the management and operations of their subsidiaries and that this somehow is appropriate and even efficient. The reality is that parent companies are, and should be, quite involved in overseeing and controlling the operation of their subsidiaries because they are required to be by both federal law and state law, and because it is efficient and in the public interest for them to be so involved.

D. The Rationale Underlying the Myth

Limited liability for shareholders is neither inevitable, nor automatic. It is a manifestation of social engineering. As an historical matter, until somewhat recently corporate law in the United States often did not provide for limited liability for shareholders.[145] As Morton Horwitz has observed, "truly limited shareholder liability was far from the norm in America even as late as 1900."[146] As a theoretical matter, the concept of complete corporate separateness was required in order to make the idea of limited liability

[145] E. Merrick Dodd, *The Evolution of Limited Liability in American Industry: Massachusetts*, 61 HARV. L. REV. 1351, 1356 (1948).

[146] Morton Horwitz, *Santa Clara Revisited: The Development of Corporate Theory,* 88 W. VA. L. REV. 173, 208 (1985).

defensible, or at least coherent.[147] In other words, it is because certain forms of business organizations are considered to be legal entities unto themselves, separate and distinct, from their own investors, their investors' risk of loss is capped at the amount of their capital contributions to the firm.

With this in mind, it is easy to see how the myth of corporate separateness between parents and subsidiaries came to dominate American legal thought. It is logical to conclude that if corporations are considered separate and distinct from their investors as a matter of theory and law, then we must require them to be separate as a matter of fact. Empirically speaking, however, this is not the case. Courts tend to recognize the practical reality of parental control and involvement in the activities of their subsidiaries and seldom impose liability on parents for the actions of their subsidiaries.[148]

It is fortunate that there is a gap between theory and practice in the sense that, from a normative perspective, it would be highly inefficient to enforce a rule requiring the separation of the management, activities and oversight of parents and subsidiaries and affiliates. Parent companies and specialized affiliates have a number of valuable capabilities, from the provision of legal and auditing services to the provision of environmental oversight. Utilizing these capabilities at the subsidiary level as well as at the parent level of operations improves the quality and the efficiency of the parents operations saves real resources, and protects valuable shared assets such as the environment.

The gap between myth and reality in the law of piercing the corporate veil is not without costs, however. While it appears to be the case that courts have not run amuck and flagrantly imposed liability on parent companies who are involved in the activities of their subsidiaries, the gap does create doctrinal confusion and leads to the inefficient waste of real resources in two ways. First, while not susceptible of precise empirical measurement, the gap between myth and reality in the law of piercing the corporate veil very likely leads to an underinvestment in parent company monitoring of the activities of their subsidiaries. When considering how much to invest in monitoring and control their subsidiaries, parent companies inevitably will balance the

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[147] *See id*. at 185–86 (discussing early theories of the corporation and the possibility of limited liability under them).

[148] Peter B. Oh, *supra* note 127 (Veil-piercing between parent and subsidiary occurs less frequently in the parent-subsidiary context than in the context of an individual suing a closely held corporation); Matheson, *supra* note 112, at 1092, 1115 ("Courts seldom pierce the subsidiary's corporate veil and do so much less often than in the overall universe of piercing cases, including the classic case of a small business with one or a few individual owners. *Id*. at 1085 (Noting a "a clear reluctance of courts to hold the parent liable for the acts of the subsidiary barring some fraud/misrepresentation or some truly extraordinary and excessive parental control or dominance.").

costs of such monitoring and control against the benefits. Consideration of litigation risk under a theory of piercing the corporate veil will be an important part of the calculus of costs for parent companies for two reasons. First, even though the probability of success for plaintiffs is low in these cases, litigation costs likely are substantial.[149] Second, there is a perception, which is probably accurate, that even though losing a case is highly unlikely, such a loss likely would impose draconian costs on the parent.

Second, the gulf between myth and reality in this area leads to the excessive litigation that inevitably accompanies confusion in the law. Few if any areas of the law are marked by as much analytical confusion as the field of piercing the corporate veil. This has led to piercing the corporate veil being the most heavily litigated area of corporate law. The significant amount of high stakes litigation in this area wastes real resources that would otherwise be used in more productive economic endeavors.

While the waste of resources in litigating these cases may impose a burden on investors and on the economy generally, these costs are not borne uniformly across society. In fact, from the perspectives of the cadres of attorneys who litigate these cases, there is no such thing as "excessive" litigation. Lawsuits, and the concomitant legal fees that accompany them, are a benefit and a source of income, not a cost. As such, from a public choice perspective, there may be precious little incentive to reduce the gap between myth and reality in the law of piercing the corporate veil.

VI. The Myth That a Level Playing Field Can be Created (and thus Markets Can be Made "Fair") by Regulating Insider Trading and Requiring the Disclosure of Material, Nonpublic Information

A. The Myth

The gap between myth and reality in the theory and practice of mandatory disclosure and insider trading law is similarly vast. The myth in this area of the law is the conceit that trading in securities markets can be made "fair"[150] by eliminating the asymmetry of information that

[149] Matheson, *supra* note 112, at 1122 (it is likely that there are "relatively greater litigation resources available to entities to deal with the complex issues presented in piercing cases, such as proving that management is non-functioning or that a subsidiary is dominated by the parent.").

[150] In this article I do not embrace any particular definition or conception of what is "fair" in the context of insider trading. Rather, I simply point out that fairness in this context generally is construed to mean a trading market that is characterized by a "level playing field" with respect to access to material nonpublic information. The point here is that the idea that insider trading law can or does achieve this version of fair capital markets is a myth.

characterizes the relationship between informed traders and uninformed traders through mandatory disclosure rules, or by regulating trading by those with an information advantage over their counterparties. The notion is that removing informed traders from the marketplace will create a "level playing field" among traders. This view, embraced by "regulators, legislators, judges, and scholars" is that that informational asymmetries are bad for ordinary investors.[151] Other scholars and judges disagree, and take the view that there is nothing inherently wrong with trading on the basis of an informational advantage over one's counterparty, so long as the party with the informational advantage has a legitimate claim to the intellectual property rights in the information that provides the basis for trading.[152]

The point here is not to rehash the decades-old debate about the normative desirability of either mandating disclosure of non-public information or of prohibiting trading by insiders. Rather, the point is that the assumption, made by *both* proponents of mandatory disclosure and insider

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[151] Kevin S. Haeberle, *Information Asymmetry and the Protection of Ordinary Investors* (June 21, 2019), *available at* SSRN: https://ssrn.com/abstract=3222292 or http://dx.doi.org/10.2139/ssrn.3222292 (accessed June 25, 2019), *forthcoming*, U.C. DAVIS L. REV. (2019). *See also* Joel Seligman, *The Reformation of Federal Securities Law Concerning Nonpublic Information*, 73 GEO. L.J. 1083, 1090 (1985) (championing a "parity of information" approach to insider-trading law); *id*. at 1115 ("The primary policy reason for proscribing trading while in possession of material nonpublic information is to make investors confident that they can trade securities without being subject to informational disadvantages."); Chiarella v. United States, 445 U.S. 222, 251 (1980) (Blackmun, J., dissenting) ("persons having access to confidential material information that is not legally available to others generally are prohibited . . . from engaging in schemes to exploit their structural informational advantage through trading in affected securities"); SEC, *Selective Disclosure and Insider Trading*, 64 FED. REG. 72590, 72592 (1999) (The SEC's Fair Disclosure rule requiring simultaneous disclosure of material information is designed to help increase "fundamental fairness to all investors"). The investor-protection view continues to animate the law today. *E.g.*, Brief for the United States, Salman v. United States, No. 15-628, *18 (filed Aug. 1, 2016) (available on Westlaw at 2016 WL 4088380) (focusing on "the unfairness of allowing a corporate insider to take advantage of information" unavailable to outsiders (quotation marks omitted)).

[152] For a court case taking a property rights approach to insider trading law, *see* Diamond v. Oreamuno, 24 N.Y.2d 494, 248 N.E.2d 910, 301 N.Y.S.2d 78 (1969). For academic commentary, *see* STEPHEN M. BAINBRIDGE, CORPORATION LAW AND ECONOMICS 598-605 (2002); J. Morgan, *Insider Trading and the Infringement of Property Rights,* 48 OHIO STATE L.J. 79 (1987)*;* Jonathan Macey, *From Fairness to Contract: The New Direction of the Rules Against Insider Trading*, 13 HOFSTRA L. REV. 9, 12, 27-29, 36-39 (1984); Dennis Carlton & Daniel Fischel*, The Regulation of Insider Trading,* 35 STAN. L. REV. 857, 859, 866 (1983); Michael C. Dooley, *Enforcement of Insider Trading Restrictions*, 66 VA. L. REV. 1, 21, 64 (1980); Frank Easterbrook, *Insider Trading. Secret Agents, Evidentiary Privileges and the Production of Information*, 1981 Supp. CT. REV. 309, 310, 331 (1981); Kenneth Scott, *Insider Trading: Rule l0b-5, Disclosure and Corporate Privacy*, 9 J. LEGAL STUD. 801, 814 (1980).

trading regulation, as well as by opponents of such rules, is that levelling the informational playing field among traders is a possibility. Here, I argue that this is a myth.

The fairness argument has a powerful intuitive appeal and is based on the premise that capital markets cannot function unless they are perceived to be fair. As one SEC official has observed:

> one of the main reasons that capital is available in such quantities in the U.S. markets is basically that the investor trusts the U.S. markets to be fair. *Fairness is a major issue. Even though it sounds simplistic, it is a critical factor and one that is absent, really to a surprising degree in many of the sophisticated foreign markets*. . . .The common belief in Europe that certain investors have access to confidential information and regularly profit from that information may be the major reason why comparatively few Europeans actually own stock. [This may] partially explain why the U.S. markets are so active and why so much money is available for those companies that seek to enter U.S. markets.[153]

Often the discussion described here is grossly misapprehended as a conflict between those who support the regulation of insider trading in order to support "fair" markets and those who oppose the regulation of insider trading because they reject the core premise of those who say insider trading is unfair, which is that it is "unfair" to trade on the basis of an informational advantage over one's counter-party.[154] But this is a false dichotomy because it fails to take account the fact that nobody is in favor simply of *allowing* insider trading. The category of jurists, scholars and policymakers who are in favor or immunizing those who trade on insider information from legal liability consists of exactly zero persons. At most there are those who would take a "Coasean approach" and leave it to securities issuers and competitive stock exchanges to formulate the applicable rules on a firm-by-firm basis.[155]

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[153] Thomas C. Newkirk & Melissa Robertson, *Insider Trading – A U.S. Perspective*, Speech to the 16th International Symposium on Economic Crime Jesus College, Cambridge, Eng. (Sept. 19, 1998) https://www.sec.gov/news/speech/speecharchive/1998/spch221.htm#FOOTBODY_19.

[154] Haeberle, *supra* note 147.

[155] Jonathan R. Macey & David D. Haddock, *A Coasian Model of Insider Trading*, 80 NW. U. L. REV. 1449, 1451, (1986) (arguing that "[w]hile the SEC's present rules banning insider trading may well be supportable under certain theoretical conditions, the SEC's refusal to permit firms to opt out of its rules suggests to us that the ban is motivated by political rent seeking rather than a quest for economic efficiency"). *See also id.* at 1468

In other words, even those most closely associated with the notion that insider trading should be legalized do not support a mandatory rule condoning such trading. Rather, at most, the so called "proponents" of insider trading regulation merely support an optional system that would allow companies to determine for themselves (by opt-in or opt-out rules) who should be allowed to trade in their shares, and on what basis.[156]

Thus, the argument here is not that insider trading should be allowed. Nor is the argument here that insider trading rules should be curtailed, much less eliminated. Rather the argument here is over the *theoretical basis* for the regulation of insider trading. Specifically, the argument is that insider trading is wrongful because it involved the theft of a valuable intellectual property interest, which is material non-public information. Insiders should be prohibited from using material non-pubic information that is supposed to be used for a valid corporate purpose just as people generally should be prohibited from appropriating other people's intellectual property.

The argument here is simply that attempts to justify the rules against insider trading on fairness grounds rather than on property rights grounds seek to substitute unsubstantiated myth over real world reality. The most complete expression of the fairness conception of insider trading law is SEC Regulation FD (the "FD is for "Fair Disclosure"), which took effect in October 2000 and banned what is known as "selective disclosure," which is the disclosure of information by corporate insiders to particular analysists and traders rather than simultaneously to "the market" as a whole.[157] "Reg. FD," as it is known, addresses the perceived problems that arise when the material insider information in the possession of publicly traded companies and other issuers is selectively disclosed. Selective disclosure occurs when information is disclosed to a small number of individuals rather than to the market as a whole through a press release, press conference or some other method designed to effectuate the simultaneous, as opposed to the selective, disclosure of information to all market participants.

Regulation FD provides that when an issuer discloses material nonpublic[158] information to certain individuals or entities—generally,

("The legal prohibition against insider trading prevents shareholders from reaching compensation agreements with the managers of their firms that would make both sides better off. Thus, while insider trading law might provide for centralized monitoring of insider activities, the per se prohibitions on insider trading reflected in the current law seem deleterious to ordinary shareholders.").

[156] Henry G. Manne, *The Case for Insider Trading*, THE WALL ST. J., Mar. 17, 2003 (assuming that corporations could "regulate the practice themselves before the SEC got into the act.").

[157] SEC Regulation FD, 17 C.F.R. § 243.100 (2000).

[158] The term "nonpublic" in this context simply refers to any relevant information that is not already impounded in a company's share price. For an attempt at a more precise

securities market professionals, such as stock analysts, or holders of the issuer's securities who may well trade on the basis of the information—the issuer must make public disclosure of that information. In this way, commentators have observed, Regulation FD aims to promote the full and fair disclosure.[159] Regulation FD is a reflection of the SEC's "traditionally expressed concern about insider trading and the effect of that trading on the fairness and integrity of the securities markets."[160]

The myth here is that the markets properly are characterized as unfair if disclosure is selective but can be characterized as fair (or at least less unfair) if selective disclosure effectively is banned (or at least inhibited). The SEC's view is that fairness requires that those "who possess material nonpublic information, must disclose it before trading or abstain from trading until the information is publicly disseminated."[161] The Supreme Court has expressly rejected this view.[162] The flaw with the SEC's reasoning is that it presumes that the benefits associated with the possession of material nonpublic information, which come in the form of trading profits, will be evenly distributed if selective disclosure is prohibited. This is not true.

Taking a loosely Rawlsian approach, the fairness approach to insider trading law seeks to level the playing field by putting the least advantaged traders in the market (those who are the least well-informed because they have the poorest access to information) on an equal playing field with the most advantaged traders in the market, insiders.[163] The problem, however, as shown in the following section, is that banning insiders will not benefit the least advantaged traders. It will benefit those traders who are next in line to

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definition, *see* Cindy A. Schipani & H. Nejat Seyhun, *Defining "Material, Nonpublic": What Should Constitute Illegal Insider Information?,* 21 FORDHAM J. CORP. & FIN. LAW 327 (2016); Karl-Adam Bonnier & Robert F. Bruner, *An Analysis of Stock Price Reaction to Management Change in Distressed Firms*, 11 J. ACCT. & ECON. 95 (1989); Steven Davidoff Solomon, *In Corporate Disclosure, a Murky Definition of Material,* N.Y. TIMES: DEALBOOK (Apr. 5, 2011, 5:57 PM), http://dealbook.nytimes.com/2011/04/05/in-corporate-disclosure-a-murky-definition-of-material/?_r=0 (accessed June 25, 2019).

[159] Jill E. Fisch, *Regulation FD: An Alternative Approach to Addressing Information Asymmetry*, *in* RESEARCH HANDBOOK ON INSIDER TRADING (Stephen Bainbridge ed., Elgar 2013).

[160] *Id*.

[161] The SEC Hist. Soc'y, *Fair to All People: The SEC and the Regulation of Insider Trading,* *Dirks v. SEC*, http://www.sechistorical.org/museum/galleries/it/counterAttack_c.php

[162] *Id*. ("The Court (rejected the SEC's view that anyone who received non-public information from a corporate insider "inherited" the insider's legal obligation to either make the information public or abstain from trading."). *See* Adam C. Pritchard, *Justice Lewis F. Powell, Jr. and the Counterrevolution in the Federal Securities Laws*, 52 DUKE L.J. 841, 942 (2003).

[163] JOHN RAWLS, A THEORY OF JUSTICE 301 (1971).

obtain and assimilate information once insiders (however they are defined) are barred from trading.

B. The Reality

The argument here is simple, and relies critically on two rather obvious insights. The first insight is that securities markets cannot function without multiple traders: those transacting in securities markets trade with other people, not with themselves. The people who trade or who might trade in a particular security at a particular point in time will be referred to here as the "trading population." This population consists of both actual and potential buyers and sellers.

Second, there exists acute heterogeneity among this trading population with respect to their abilities to obtain, access, assimilate, and develop a profitable trading strategy on the basis of nonpublic information. In previous joint work with David Haddock, I have categorized the trading population for securities into three groups based on the speed with which they can access and trade on nonpublic information. [164] These groups are: (1) insiders, (2) market professionals, and (3) outsiders.[165] And while this taxonomy is useful for certain purposes, the real world, of course is much more complex, and each classification is comprised of individuals and firms with different abilities and expertise.

Under the previously developed taxonomy just described, insiders have access, because of the nature of their employment, to new firm-specific information about the present value of a firm's future cash flows. Without rules against insider trading, insiders would take the bulk of the gains in nearly every trading race that is sparked by internally occurring nonpublic information.

If insider trading rules prevent this group from trading, the securities markets will not become a level playing field. Rather the next fastest group of traders will benefit from the rules, to the extent that they are enforced. This is due to the fact that the shareholding populations of public companies are heterogeneous with respect to their ability to process the information disclosed to them by insiders, as such a fairness doctrine will not benefit all or even most shareholders. Rather, the subset of a company's shareholders who are market professionals such as hedge fund operators and professional traders in investment banking firms, will be the first to synthesize public disclosures by insiders and to effectuate trades in the capital markets based on those disclosures. These trades will cause the price of the relevant firm to

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[164] David Haddock & Jonathan Macey, *Regulation on Demand: A Private Interest Model, With an Application to Insider Trading Regulation*, 30 J. L. & ECON. 311, 317 (1987).

[165] *Id*.

adjust to its new, "correct" level, so that "true outsiders" who are the "very average investors" that the SEC purports to protect with its fairness rule ends up selling their shares before the share price has adjusted to reflect the new information.[166]

C. The Rationale Underlying the Myth

The reality is that it is not possible to create a level playing field among traders. Traders have different natural endowments, different technological resources, and different access to public data. All of this heterogeneity makes a "level playing field" impossible to achieve. Once this point is understood, then insider trading regulation can be viewed unromantically for what it should be: a mechanism for allocating property rights in information, rather than for what it is not: a mechanism for achieving "fairness" among trading parties.

But much of this dispute is merely rhetorical. What difference does it make, really, whether one sides with economists and concludes that insider trading is wrong because it involves the illegitimate theft of property rights in information or whether one sides with the SEC and concludes that insider trading is wrongful because it is unfair. The following simple example illustrates the point:[167] Suppose that a lawyer in a large law firm rifles through the files of one of her partners with a mergers and acquisitions practice and discovers that one of the firm's clients is about to make a bid to purchase all of the shares of a large publicly traded company at a substantial premium over that company's current market price. Suppose further that the lawyer, unable to resist this illicit profit-making opportunity, buys shares in the target company before the client makes its bid, and makes a significant profit selling the newly-acquired shares in the market after the client publicly announces its bid for the target.

This behavior unambiguously would be considered odious under either the economic/property rights approach to insider trading or under the fairness approach. The fairness approach would consider the lawyer's purchases as undesirable on fairness grounds. Specifically, the unfairness involved with the lawyer's purchases is that the lawyer traded on the basis of

[166] Jonathan R. Macey & David Haddock, *Regulation on Demand: The Influence of Special Interest Groups on SEC Enforcement of Insider Trading Rules,* 30 J. L. & ECON. 311 (1987); David Haddock & Jonathan R. Macey, *A Coasean Model of Insider Trading,* 80 NW. U. L. REV. 1449 (1986).

[167] This example is adapted from a somewhat different example used in Jonathan R. Macey, *Beyond the Personal Benefit Test: The Economics of Tipping by Insiders*, 2 U. PENN. J. L. & PUB. AFF. 25 (2017).

an unfair informational advantage since the lawyer knew of the client's impending bid, while the selling shareholder did not.

The lawyer's purchases of the target company's shares prior to the client's public announcement would be equally reprehensible under an economics/property rights approach, but for an entirely different reason. From an economic or property rights point of view, the lawyer has acted wrongfully because she improperly acted to the detriment of the client by converting the client's valuable information about its planned takeover bid into a trading strategy of her own.

Building on the observation that the client necessarily had to invest significant resources in identifying the target company, researching the arbitrage opportunities associated with determining that the target was undervalued due to its poor management or its inability to avail itself of possible synergies by combining with another company, the property rights/ economic efficiency approach to insider trading posits that the potential harm from the trading is borne by the bidding client. Specifically, to the extent that the lawyers' buying drives up the price of the target company's shares, such buying increases the costs of its proposed acquisition. In other words, eschewing the property rights/ efficiency approach seeks to protect the bidding firm's property rights in the information that the target company is undervalued, thereby presenting an arbitrage opportunity in the market for corporate control. From an efficiency standpoint, the harm caused by the insider's buying in advance of her client's bid is two-fold. First the purchasing risks driving up the price of the target company's shares, thereby damaging the client by increasing the costs of its acquisition. Second, the lawyer's purchases risk scuttling the deal entirely, if the upward share price adjustment caused by the insider's trading makes the transaction prohibitively expensive for the bidder.

Analytically, the property rights/economic efficiency approach to insider trading law is superior to the fairness approach even though the lawyer's actions are equally illegal under both approaches. The problem with the fairness approach is that the fairness approach cannot explain why the law firm's client, the bidding firm, is permitted to trade when the lawyer is prohibited from trading. Critically, from the perspective of the shareholder in the target firm who is selling, the result is the same regardless of whether the shareholder's shares are sold to the client or to the lawyer. The result is that the target firm shareholder has sold to a counter-party with a clear informational advantage in the form of inside information about a takeover bid that was not available to the target firm shareholder. On the other hand, from an economic/property rights perspective, while the trading by the lawyer clearly is disallowed,[168] the purchases by the bidding firm, notwithstanding its informational advantage, are condoned because the bidder is the entity to which the property rights in the relevant information are properly assigned. In other words, the property rights/ efficiency approach to insider trading law is both more in line with one's natural intuitions about what fairness requires as well as with actual law. Under the law, while the lawyer's trading clearly is prohibited, the bidder's purchases, with certain technical restrictions, are legal and permissible.[169]

As a political matter, however, the fairness approach to insider trading has a clear advantage over the property rights/ efficiency approach. Cosmetically, the fairness approach is cast as a theory of insider trading liability that protects markets and the financial system. This is a very valuable marketing device for the regulation. On the other hand, the property rights/ economic approach is criticized, not for the results it produces - which are generally no different from the results generated by the fairness approach – but on the cosmetic basis that the fairness approach does not serve the noble public purposes of protecting capital markets and protecting investors but the mundane, quotidian purpose of protecting property rights in nonpublic information and policing internal employment arrangements within firms, such as the lawyer's employment relationship with her law firm that is exploited in the example above.

Despite its analytical flaws, the fairness justification for regulating insider trading is distinctly superior to the property rights/ efficiency regulatory justification from the SEC's bureaucratic point of view for two reasons, both of which should be familiar to those working in the field of

[168] This hypothetical is generally the fact pattern that led to the conviction of the lawyer/defendant in U.S. v. O'Hagan, 521 U.S. 642 (1997).

[169] The Williams Act, Pub. L. No. 90-439, 82 Stat. 454 (1968) (codified as amended at 15 U.S.C. §§ 78m(d)-(f), 78n(d)-(e) (1982)) has curtailed, but not eliminated the ability of acquirers to capture the full gains of their costly search and analysis. The Williams Act requires bidders to disclose their identity and plans within 10 days after acquiring a 5 percent stake in a publicly traded target company. Securities Exchange Act, Rule 13-d, Schedule 13D, 17 C.F.R. 240.13d-1, 240.13d-7 (1986). While in theory it is possible for a bidder to acquire 100% of a target company's stock within 10 days of crossing the 5 percent threshold, as a practical matter, such a rapid flurry of purchases would drive the target company's share price prohibitively high. Jonathan Macey & Jeffry Netter, *Regulation 13D and the Regulatory Process,* 65 WASH. U. L.Q. 131 (1987); Haddock, Macey & McChesney, *Resistance to Tender Offers and Optimal Property Rights in Assets,* 73 VA. L. REV. 701 (1987); Jarrell & Bradley, *The Economic Effects of Federal and State Regulation of Cash Tender Offers,* 23 J.L. & ECON. 371 (1980) (observing that Regulation 13D and other regulations that require immediate disclosure of information about an acquirer's identity and plans regulations, have diluted acquiring firms' property rights in information and led to significant welfare losses by reducing search for undervalued firms and reducing the incidence of wealth creating transactions, such as synergy-creating mergers, and hostile acquisitions that displace inefficient or corrupt management).

public choice,[170] an academic approach to studying bureaucracy from which the SEC is far from immune.[171] Of particular relevance is Anthony Downs' *Inside Bureaucracy,* which observes that bureaucracies will gradually and inevitably substitute their original, publicly articulated goals, such as protecting consumers or achieving more efficient markets goals that further the ends of the bureaucracy.[172]

First, framing the justification for insider trading law in terms of "fairness" rather than in terms of efficiency serves the bureaucratic end of preserving the SEC's pivotal role in regulating insider trading. After all, markets do not become fair by themselves. Framing insider trading regulation as a quest for fairness indicates that a regulatory agency is required to achieve the policy goal of promoting fairness. In sharp contrast, it is not at all clear what, if any, role should be played by bureaucracy under the alternative property rights/ economic efficiency approach to insider trading regulation. After all, if the fairness considerations of the SEC are "better analyzed in contractual terms," [173] then the SEC's role in policing the capital markets for insider trading is profoundly diminished. Under a contractual approach that seeks to protect property rights and promote the efficient use of nonpublic information, the firms that own such information conceivably adopt different, bespoke internal corporate guidelines pertaining to insider trading. Rather than setting the rules and policing the markets, the SEC would be left to a passive role of monitoring the markets and enforcing the internal governance rules of the companies that they currently regulate. According to the SEC the "mission" of the agency is "to protect investors; maintain fair, orderly, and efficient markets; and facilitate capital formation."[174] Further the SEC seeks to garner public support for itself

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[170] Leading work in the field includes George Stigler, *The Theory of Economic Regulation,* 2 BELL J. ECON. & MGMT. SCI. 3 (1971), and Sam Peltzman, *Toward a More General Theory of Regulation,* 19 J. L. & ECON. 211 (1976).

[171] *See e.g.* S. PHILLIPS & J. ZECHER, THE SEC AND THE PUBLIC INTEREST 21-23 (1981); George Stigler, *Public Regulation of the Securities Markets*, 37 J. BUS. 117 (1964); George Benston, *Required Disclosure and the Stock Market: An Evaluation of the Securities Exchange Act of 1934*, 63 AM. ECON. REV. 132 (1973). Jonathan R. Macey & David Haddock, *Shirking at the SEC: The Failure of the National Market System,* 1985 U. ILL. L. REV. 315; Greg Jarrell, *Change at the Exchange: The Causes and Effects of Deregulation*, 27 J. L. & ECON. 273 (1984).

[172] ANTHONY DOWNS, INSIDE BUREAUCRACY (1967); *See also* WILLIAM NISKANEN, BUREAUCRACY AND REPRESENTATIVE GOVERNMENT (1968) (once formed, a bureaucracy will maneuver to receive demands a budget which will satisfy not only the production and cost functions reflecting the supply of the public goods, but also their own utility functions.

[173] *See* Jonathan R. Macey, *From Fairness to Contract: The New Direction of the Rules Against Insider Trading*, 13 HOFSTRA L. REV. 9 (1984).

[174] The SEC, *About the SEC*, https://www.sec.gov/about.shtml (accessed June 26, 2019).

through claims that it "strives to promote a market environment that is worthy of the public's trust."[175] Politicians and the general public are more likely to favor the expansive use of public funds to support a bureaucracy if they believe that it exists "to protect investors, to maintain fair, orderly and efficient markets and facilitate capital formation"[176] than they are to favor the use of public funds to support a bureaucracy whose work merely enforces internal agreements within firms about how to allocate and manage the use of nonpublic information.

To summarize, the myth that insider trading regulation serves the interests of the ordinary trading public serves the private, bureaucratic interests of the SEC by providing a pretext for justifying the broad public funding and support that the agency enjoys. Rejecting the myth of insider trading regulation would harm the SEC's own bureaucratic interests by diminishing its power and prestige. If the general public and politicians were come to recognize that insider trading regulation merely serves the mundane role of protecting property rights in information and enforcing internal contractual arrangements within firms, its enthusiasm for supporting the SEC likely would diminish.[177]

Clearly, the SEC's role in policing capital markets is not limited to its role in promulgating and enforcing rules regulating insider trading. In particular, the SEC's Division of Trading and Markets, which regulates the major securities market participants, including broker-dealers, self-regulatory organizations (such as stock exchanges, FINRA, and clearing agencies), and transfer agents, establishes and maintains standards for fair, orderly, and efficient markets.[178] For example, the Division of Trading and Markets recently has adopted capital, margin, and segregation requirements for security-based swap dealers and major security-based swap participants,[179] amended the capital and segregation requirements for broker-dealers,[180] proposed risk mitigation techniques for uncleared security-based swaps,[181] and adopted an important transaction fee pilot to study the effects of predatory multi-tiered exchange transaction fee and rebate pricing models

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[175] *Id*.

[176] The SEC, *Our Goals*, https://www.sec.gov/our-goals

[177] The SEC protects capital markets in other ways besides its regulation of insider trading.

[178] The SEC, *Trading and Markets*, https://www.sec.gov/page/tmsectionlanding.

[179] The SEC, *SEC Adopts Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Amends the Capital and Segregation equirements for Broker-Dealers,* https://www.sec.gov/news/press-release/2019-105.

[180] *Id*.

[181] The SEC, *SEC Proposes Risk Mitigation Techniques for Uncleared Security-Based Swaps*, https://www.sec.gov/news/press-release/2018-294.

on order routing behavior, execution quality, and market quality generally.[182]

The SEC's work in protecting the capital markets is important and deserves public support, to the extent that it serves the public interest and not the private interests of powerful groups such as high frequency traders and stock exchanges.[183] Thus, the point here is not that the SEC has no role to play in policing U.S. capital markets.[184] Rather, the point is that regulating insider trading plays an important role in justifying the SEC's existence and budget, and that the perception that insider trading regulation makes markets fairer and does not merely protect property rights, serves the SEC's private bureaucratic interests, despite the fact that it is a myth.

From the SEC's bureaucratic perspective, a second disadvantage to characterizing the insider trading regulation as an issue of property rights and efficiency rather than of basic fairness is that the efficiency characterization serves as a justification for private ordering, and deprives the SEC of its role in determining what trading conduct should be permitted and what trading conduct should be prohibited. This is due to the fact that if the proper scope of insider trading is subject to contractual modification and to negotiation, the role of the SEC is categorically diminished.

The SEC's problem is evident in the Supreme Court's insider trading jurisprudence, which rejects the fairness myth to avoid liability and adopts a variant of the contractual/ property rights approach.[185] Much to the SEC's

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[182] The SEC, *SEC Adopts Transaction Fee Pilot for NMS Stocks*, https://www.sec.gov/news/press-release/2018-298.

[183] A strong indication that this work is in the public interest can be found in the fact that special interest groups that are benefitting from the status quo market structures have pulled out all the stops to oppose the SEC's efforts to correct existing problems in the structure of U.S. capital markets. *See* Dave Michaels, *Stock Exchanges Accuse Government of Ethics Lapse in Market-Data Fight: NYSE, Nasdaq Say Senior SEC Official Brett Redfearn Has Ethical Conflicts Because of Prior Wall Street Work*, WALL ST. J. (June 25, 2019), https://www.wsj.com/articles/stocks-exchanges-accuse-government-of-ethics-lapse-in-market-data-fight-11561423837.

[184] *But see* Jonathan R. Macey, *Administrative Agency Obsolescence and Interest Group Formation: A Case Study of the SEC at Sixty*, 15 CARDOZO L. REV. 909 (1994) (arguing that the SEC is obsolete). The rise of high frequency traders, dark pools of capital, and predatory stock exchanges have, I believe, created a new and important role for the SEC in overseeing market structure. Jonathan Macey & David Swensen, *Recovering the Promise of the Orderly and Fair Stock Exchange*, 42 J. CORP. L. 778 (2017).

[185] Chiarella v. U.S., 8 445 U.S. 222 (1980). In Chiarella, Justice Powell, speaking for the Court "rejected the (SEC's) broad theory, based on the unfairness of inequality of information … on the ground that the federal securities laws could not be projected to reach such a conclusion based on any discernible intent of the Congress in the legislative history of section 10(b) and that attempting to reach such a conclusion would, in fact, be legislation which should be left by the Court to Congress. Harry Heller, *Chiarella, SEC Rule 14e-3 and Dirks: Fairness versus Economic Theory,* 37 BUS. LAW. 517, 538 (1982). S*ee also* Jon Eisenberg, *Insider Trading Law After Salman*, HARV. L. SCH. F. ON CORP. GOV. AND FIN.

chagrin, the Supreme Court emphatically has held that insider trading restrictions are not grounded on general notions of fairness, but rather on pre-existing contractual obligations that create fiduciary obligations on agents to refrain from engaging in trading that harms the interests of the principal.[186] In particular, the Supreme Court had held there can be no legal or regulatory prohibition against insider trading unless such trading violates a pre-existing contractually based, fiduciary duty of trust and confidence.[187] Having rejected the SEC's "fairness as the elimination asymmetries of information" defense of insider trading law, under current law, to avoid liability, all that an insider in possession of inside information needs to do is to "disclose his trades to the principal in the fiduciary relationship, not to the investors with whom he trades."[188] According to the Court, "if the fiduciary discloses to the source (of the information) that he plans to trade on the nonpublic information, there is no 'deceptive device' and thus no 10(b) violation."[189]

Thus, the rejection of the level playing field myth transforms the traditional prohibition on insider trading from its prior vaunted status as an immutable, mandatory principle of market fairness into a mere customizable default rule. This transformation deprives the SEC of its customary authority to promulgate the rule. At most, the SEC can determine what the default rule is, and firms are free to amend it.

REG., (Jan. 18, 2017) ("the Supreme Court long ago rejected the government's equal-access (fairness) theory of insider trading, and instead required a breach of a duty of trust and confidence to support insider trading liability. The breach must involve a personal benefit to the insider or "misappropriator."). https://corpgov.law.harvard.edu/2017/01/18/insider-trading-law-after-salman/. (accessed June 26, 2019).

[186] The Supreme Court's opinion in *Dirks v. SEC*, "sharply points up the antagonism between the legal predilection for "fairness" in the distribution and availability of material "inside" or "market" information and the economist's concern for market efficiency. Heller, *Chiarella, SEC Rule 14e-3 and Dirks: Fairness versus Economic Theory, supra* note 181.

[187] In *O'Hagan*, 521 U.S. 642, the Court made clear that "the misappropriation theory outlaws trading on the basis of nonpublic information by a corporate 'outsider' in breach of a duty owed not to a trading party, but to the source (owner) of the information."

[188] Richard W. Painter, Kimberly D. Krawiec & Cynthia A. Williams, *Don't Ask, Just Tell: Insider Trading after United States v. O'Hagan*, 84 VA. L. REV. 153, 174 (1998).

[189] *O'Hagan*, 521 U.S. 642.

VII. Conclusion

The common perceptions that myths are misapprehensions that should be corrected and dispelled reflects a lack of understanding of the true nature and role of myths in legitimizing and rationalizing law. This Article has shown that certain basic precepts of corporate law are based on myth rather than on fact. In particular, four myths are identified. The first myth is that corporations are owned by their shareholders, and that shares of stock represent ownership interests in businesses rather than mere contracts that represent financial claims on the cash flows of those businesses, and provide for certain political (voting) rights as a means for safeguarding those claims. This myth serves the social function of legitimizing the current practice of giving corporations the same rights as actual flesh and blood people. The notion of shareholders as owners also tends to anthropomorphize the corporations and undermines the principle that corporations can be regulated more pervasively than individuals because they are mere creations of the state.

The second mythical precept of corporate law is what is known as "the shareholder value myth." This myth was described by Lynn Stout in a book of the same name as the myth that corporate officers and directors are legally required to maximize firm value. While Professor Stout was correct in her conclusion that the legal obligation to maximize shareholder value is a myth, the analysis here departs from Professor Stout's in one crucial respect. Professor Stout viewed the shareholder wealth maximization myth as pernicious, while I view it as benign.

According to Professor Stout, the shareholder wealth maximization myth endangers both investors and society as a whole because it leads managers to focus myopically on short-term earnings, discourages investment and innovation, harms employees, customers, and communities, and generally "causes companies to indulge in reckless, sociopathic, and irresponsible behaviors."

In contrast, I think that Professor Stout failed to recognize the societal benefits of the shareholder wealth maximization myth. First, the shareholder value myth is efficient because it provides a justification for the actively enforced legal rule that conduct that involves stealing and self-dealing is prohibited. The myth that corporations must be run for the benefit of their shareholders, like the myth that shareholders own the corporation, serves the socially useful function of causing managers to internalize the norm that the only morally justified course of action is to maximize value for shareholders. Thus, the shareholder value myth has led to the creation of a useful and productive norm that corporate officers and directors should serve the interests of their shareholders. Thus, even beyond inhibiting pilfering, the shareholder wealth maximization myth induces corporate managers to avoid taking any action that is blatantly or flagrantly inconsistent with the shareholder primacy norm. Similarly, the shareholder value myth constrains managers from taking any actions that cannot be justified at least on the pretext that they further the goal of shareholder wealth maximization.

The third myth analyzed in this Article is the myth that subsidiary companies must be independent from and not subject to the control of their parent companies in order for the parent company to avoid liability for the contract and tort debts of the subsidiary under various alter ego and piercing the corporate veil theories of corporate law. In fact, I show that parent companies axiomatically and automatically control their subsidiaries by virtue of their ability to elect the directors that manage such subsidiaries. Moreover, I show that the mythical separation of subsidiary companies from their parent companies and affiliates would be highly undesirable from an efficiency point of view because it would prevent corporate groups from leveraging the expertise cabined in various corporate entities across all of the subsidiaries and affiliates that constitute the group, and because it would require needless duplication of resources by preventing corporate groups from achieving the economies of scale and scope that are possible when activities are provided by the parent or an affiliate to all of the subsidiaries within a corporate group. However, as a political matter, the myth that parent companies are distinct from their subsidiaries does serve the valuable palliative function of justifying the rule that parent companies' liability for the debts of their subsidiaries is capped at the amount of the parents' initial investment in the subsidiary.

The fourth and final political myth analyzed in this Article is the venerable myth that the legal regulation of insider trading is justified because such trading is "unfair" and damages the integrity of the nation's capital markets. While unregulated insider trading clearly is detrimental to capital markets and inefficient, the justification for legal constraints on insider trading is not that such constraints are required by notions of fairness, but because they are efficient and necessary to protect valuable intellectual property rights in nonpublic information that belongs to publicly traded companies. However, the myth that insider trading regulation promotes fairness serves important social function of galvanizing strong public support for insider trading regulation. The myth that insider trading regulation promotes fairness where fairness is defined as asymmetry of information among trading parties also serves the private, bureaucratic interests of the SEC in increasing political support and justifying the allocation of resources to the agency.

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