The “Long Term” in Corporate Law

*By J.B. Heaton**

To read influential corporate lawyers, legal academics, and jurists, shareholders are an alarmingly myopic bunch who demand that corporate directors and managers make short-term decisions that sacrifice long-term value. But here is the mystery: there is virtually no evidence that shareholders prefer short-term gains that are smaller than larger (discounted) long-term gains.

This article makes a simple claim: the short term/long term rhetoric in Delaware corporate law masks the real battle, one between a rational desire by clear-sighted shareholders for shareholder value maximization, on the one hand, and a desire by courts and others for corporate longevity—i.e., long-term corporate survival—on the other. Corporate law directs, or at least allows, directors to manage for long-term survival under cover of long-term shareholder wealth maximization, i.e., a state of sufficient ongoing profitability that allows the corporation to exist for as long as possible, regardless whether that level of profitability actually is value-maximizing for shareholders.

The problem this raises is obvious: if Delaware allows corporations to prioritize longevity, then that is a goal often at odds with what shareholders want. Whether this policy is good or bad for society, I leave for another day. But so long as Delaware leaves the power of the vote with shareholders while giving directors a hidden power to act against shareholder interests in the name of corporate longevity, we can expect (and will continue to see) shareholder objections and activist efforts in many cases where corporations are worth more in different form, whether differently oriented, smaller, acquired and merged into larger organizations, or liquidated and dead altogether.

Introduction

To read influential corporate lawyers, legal academics, and jurists, shareholders are an alarmingly myopic bunch who demand that corporate directors and managers make short-term decisions that sacrifice long-term value.[1] The basic

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1. *See, e.g.*, Thomas Lee Hazen, *The Short-Term/Long-Term Dichotomy and Investment Theory: Implications for Securities Market Regulation and for Corporate Law*, 70 N.C. L. Rev. 137, 138 (1991) (“It is a popularly held belief that managers of publicly held companies in the United States are preoccupied with the current value of the company and its shares, thereby neglecting the long-term interests of the firm.”).

criticism goes back decades.[2] In 1979, Martin Lipton wrote of the divergent interests of "investors with short-term interests" who "do not share the concern of corporate management with the need for long-term planning in a high technology economy"[3] The group receiving the most scolding of late are hedge fund activists. Critics claim that "public corporations are increasingly under pressure to incur debt and apply earnings to fund payouts to shareholders, rather than to make long-term investments."[4] The Chief Justice of the Delaware Supreme Court and commentator on corporate law, Justice Leo E. Strine, Jr., says we "must recognize that directors are increasingly vulnerable to pressure from activist investors and shareholder groups with short-term objectives, and that this pressure may logically lead to strategies that sacrifice long-term performance for short-term shareholder wealth."[5] The distinction between short-term and long-term shareholder wealth allows critics like Chief Justice Strine to dismiss overwhelming empirical evidence that shareholders benefit, on average, from the actions of hedge fund activists, though long-run evidence also supports the value of hedge fund activism.[6]

Delaware case law supports the distinction between short-term shareholder wealth and long-term shareholder wealth. Directors must maximize the "long run interests of shareholders"[7] and have no duty (absent a change of control

2. Emeka Duruigbo, *Tackling Shareholder Short-Termism and Managerial Myopia*, 100 KY. L.J. 531, 540 (2012) ("For approximately three decades now, academic commentators, corporate lawyers, the investment community, and other interested parties have been commenting on the short-termism phenomenon.").

3. Martin Lipton, *Takeover Bids in the Target's Boardroom*, 35 BUS. LAW. 101, 104 (1979); *see also* Martin Lipton, *Corporate Governance in the Age of Finance Corporatism*, 136 U. PENN. L. REV. 1, 8 (1987) ("[Institutional investors'] desire for quick profits has contributed to the current wave of highly leveraged takeovers to the detriment of both undervalued companies and individual shareholders with a long-term investment motive.").

4. John C. Coffee, Jr. & Darius Palia, *The Wolf at the Door: The Impact of Hedge Fund Activism on Corporate Governance*, 41 J. CORP. L. 545, 603 (2016); *see also* Nadelle Grossman, *Turning a Short-Term Fling into a Long-Term Commitment: Board Duties in a New Era*, 43 U. MICH. J.L. REFORM 905, 906 (2010) ("[B]oard short-termism also seems to be due to some investors with short investment horizons who use activism to influence boards to make decisions that yield short-term returns despite the longer-term impairing effects those decisions might have on the corporate enterprise.").

5. Leo E. Strine, Jr., *The Dangers of Denial: The Need for a Clear-Eyed Understanding of the Power and Accountability Structure Established by the Delaware General Corporation Law*, 50 WAKE FOREST L. REV. 761, 791 (2015).

6. *See, e.g.*, Lucian A. Bebchuk, Alon Brav & Wei Jiang, *The Long-Term Effects of Hedge Fund Activism*, 115 COLUM. L. REV. 1085, 1155 (2015) (concluding that the evidence establishes that hedge fund activism is "followed by long-term improvements, rather than declines, in performance"); Alon Brav, Wei Jiang & Hyunseob Kim, *The Real Effects of Hedge Fund Activism: Productivity, Asset Allocation, and Labor Outcomes*, 28 REV. FIN. STUD. 2723, 2769 (2015) (finding that hedge fund activism improves firm productivity); Alon Brav, Wei Jiang, Song Ma & Xuan Tian, How Does Hedge Fund Activism Reshape Corporate Innovation? (May 16, 2016) (unpublished manuscript available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2409404) (finding that firms targeted by activist investors generate more patents that are of higher quality relative to a matched sample. Activists push firms to allocate internal innovation to key areas of expertise and inventors at target firms become more productive relative to those at matched firms.).

7. Strine, *supra* note 5, at 772 (quoting TW Servs., Inc. v. SWT Acquisition Corp., Civ. A. Nos. 10427, 10298, 1989 WL 20290, at *7 (Del. Ch. Mar. 2, 1989)).

transaction) to do that which "will best maximize the corporation's current stock price."[8] As Vice Chancellor Laster put it recently:

> The fiduciary obligation to maximize the value of the corporation for the benefit of its stockholders does not mean that directors must sacrifice greater value that can be achieved over the long term in pursuit of short-term strategies, and it certainly does not mean that directors must attempt to maximize the [] public company's stock price on a daily or quarterly basis. The fiduciary relationship requires that directors act prudently, loyally, and in good faith to maximize the corporation's value over the long-term for its stockholders' benefit.[9]

But here is the mystery: there is virtually no evidence[10] that shareholders ever prefer short-term gains that are smaller than larger (discounted) long-term gains. "A mass of evidence shows that shareholders are fundamentally unified behind the goal of maximizing the value of the equity."[11] Nor is there evidence that any conflict exists between short-term wealth maximization and long-term wealth maximization. Harvard Law School Professor Mark Roe put it this way recently, "[o]verall, the evidence that financial markets are excessively short-term is widely believed but not proven, and there is much evidence pointing in the other direction."[12] Commentators who complain, for example, about activists pushing for share repurchases and increased dividends at the expense of capital expenditures have never explained why shareholders would prefer lower payoffs from immediate cash if alternative uses of those funds in capital expenditures promised higher risk-adjusted returns, instead relying on a "trust me" argument that directors know better than shareholders how to increase share prices.[13]

8. *Id.* at 774.

9. Virtus Capital L.P. v. Eastman Chem. Co., Civ. A. No. 9808-VCL, 2015 WL 580553, at *16 n.5 (Del. Ch. Feb. 11, 2015) (citation omitted).

10. A few theoretical papers show that managers might act myopically in response to shareholder pressure, but they do not generate short-term stock gains at the expense of long-term stock gains. *See, e.g.*, Andrei Shleifer & Robert W. Vishny, *Equilibrium Short Horizons of Investors and Firms*, 80 AM. ECON. REV. 148 (1990) (demonstrating that short-term assets may be more accurately priced than long-term assets because of short investment horizons); Jeremy C. Stein, *Efficient Capital Markets, Inefficient Firms: A Model of Myopic Corporate Behavior*, 104 Q. J. ECON. 655 (1989) (demonstrating how managers can be trapped into taking value decreasing actions). Other theoretical work, however, shows that shareholding trading can encourage managers to invest for the long term. *See, e.g.*, Alex Edmans, *Blockholder Trading, Market Efficiency, and Managerial Myopia*, 64 J. FIN. 2481, 2481 (2009) (analyzing "how outside blockholders can induce managers to undertake efficient real investment through their informed trading of the firm's shares").

11. George W. Dent, Jr., *The Essential Unity of Shareholders and the Myth of Investor Short-Termism*, 35 DEL. J. CORP. L. 97, 105 (2010).

12. Mark J. Roe, *Corporate Short-Termism—In The Boardroom and in the Courtroom*, 68 BUS. LAW. 977, 1005 (2013).

13. *See, e.g.*, David Benoit, *Capex or Capital Return: The Data Behind the Debate on Activism*, WALL ST. J. (Mar. 11, 2015, 8:52 AM EST), http://blogs.wsj.com/moneybeat/2015/03/11/capex-or-capital-returns-the-data-behind-the-debate-on-activism/ ("[Corporate managers and their advisers] say the push to hand back cash is short-sighted and cutting capex leaves companies vulnerable. Buybacks, they say, are a often poorly timed, ineffectual and a waste of shareholder resources. And they say managers and boards are always looking out for ways to return capital, and investors need to trust them to make decisions given they have more information than outsiders."). The idea that managers are likely to waste excess cash flow by investing in negative net present value capital expenditures is the premise of one of the most-cited articles in financial economics. *See* Michael C. Jensen, *Agency*

This article makes a simple claim: the short term/long term rhetoric in corporate law masks the real battle, one between a rational desire by clear-sighted shareholders for shareholder value maximization, on the one hand, and a desire by courts and others for corporate *longevity*—i.e., long-term corporate survival—on the other. Corporate law directs, or at least allows, directors to manage for long-term existence, i.e., a state of sufficient ongoing profitability that allows the corporation to exist for as long as possible, regardless whether that level of profitability is value maximizing for shareholders.

The problem this raises is obvious: if Delaware allows corporations to focus on longevity, then that is a goal often at odds with what shareholders want. Commentators and case law suggest there should be no conflict between shareholders and directors of for-profit corporations if shareholders were just of the right sort: focused properly on the long term. But, as one court put it in a different context, "[a] corporation is not a biological entity for which it can be presumed that any act which extends its existence is beneficial to it."[14] Or, at least, not beneficial to its shareholders. However, a bias to longevity may benefit others who deal with the corporation, including "stakeholders" such as directors, managers, other employees, creditors, suppliers, customers, and even local communities. Part of my claim is that this bias is unstated, but perhaps intentional.

My objective here is to suggest that "long-term" shareholder value maximization in Delaware corporate law means something different than it is often interpreted to mean. It is a way to encourage stability and ongoing corporate existence, paid for mostly by corporate shareholders. Contrary to the language of long-term benefit to shareholders, longevity is of value because it often benefits other constituencies. Delaware law, which governs most of our country's largest corporations and certainly many of those targeted by shareholder activists, allows and encourages corporate directors and officers to subordinate shareholder welfare to corporate longevity. It does so by creating this largely false dichotomy—between the "short-term" interests of shareholders and the "long-term" interests of shareholders—when the real debate is between the interests of shareholders and the interests of most everyone else. This explanation for the role in corporate law of the "long-term" shareholder interest does not depend on unrealistic, unproven assertions of shareholder myopia and investor irrationality. Rather, it emphasizes that the focus on the "long-term" interests of shareholders as something other than maximizing current shareholder wealth is a rhetorical move, one that

Costs of Free Cash Flow, Corporate Finance, and Takeovers, 76 Am. Econ. Rev. 323 (1986). Of course, such ideas do not settle the question; the best use of corporate cash must be considered on a case-by-case basis. But it is a mistake to assume that such cash is always better invested by the corporation than paid out, which often seems the unstated premise of many activist critics. *See, e.g.*, Joe Biden, *How Short-Termism Saps the Economy*, Wall St. J. (Sept. 27, 2016, 7:14 PM EST), http://www.wsj.com/articles/how-short-termism-saps-the-economy-1475018087 ("I am not blaming CEOs. The business leaders I've met over the course of my career want to build their firms and contribute to the economy, not simply send checks to investors or buy back their own stock. Sometimes they succeed. Other times the pressures to lift the short-run share price are simply too great.").

14. *In re* Inv'rs Funding Corp. of N.Y. Sec. Litig., 523 F. Supp. 533, 541 (S.D.N.Y. 1980).

reflects an unwillingness to admit the subordination of shareholder interests that is actually occurring.

Whether this policy is good or bad for society, I leave for another day. Commentators long have debated whether the corporation is properly focused on shareholder wealth maximization at any time horizon,[15] and who should control the corporation toward what ends.[16] My point is narrower: the "long-term" interests of shareholders is a rhetorical device that hides an agenda. And so long as Delaware leaves the power of the vote with shareholders while giving directors a hidden power to act against shareholder interests in the name of corporate longevity, we can expect shareholder objections and activist efforts in many cases where corporations are worth more in different form, whether differently oriented, smaller, acquired and merged into larger organizations, or liquidated and dead altogether.

This article continues as follows.

Part I presents a simple numerical example. The idea is to illustrate how a conflict can develop between what shareholders want and what longevity might require.

Part II presents some evidence that the "long term" in Delaware corporate law means longevity.

Part III explores the idea that longevity benefits stakeholders.

I. A Simple Example

Consider the following simple example. A Delaware corporation exists for two periods, today and tomorrow. We can think of today as the "short term" and tomorrow as the "long term." We assume that the interest rate is zero and that shareholders are risk neutral. Assuming the interest rate is zero means that we do not have to discount future cash flows; assuming that investors are risk neutral means that we can value future cash flows as their expected values without making adjustments for risk aversion or risk-seeking behavior.

The corporation has a single asset today, \$100 in cash. The corporation can liquidate and return that \$100 to shareholders today, or the corporation can invest the \$100 in a project. Tomorrow, the project will return \$110 with a 60 percent probability and \$80 with a 40 percent probability. Shareholders do not like this project. It has a negative net present value because it requires investment of \$100 for an expected value of \$98 (\$110 × 60% + \$80 × 40%). If the corpo-

15. Classic articles are A.A. Berle, Jr., *Corporate Powers as Powers in Trust*, 44 Harv. L. Rev. 1049 (1931); A.A. Berle, Jr., *For Whom Corporate Managers Are Trustees: A Note*, 45 Harv. L. Rev. 1365 (1932); E. Merrick Dodd, Jr., *For Whom Are Corporate Managers Trustees?*, 45 Harv. L. Rev. 1145 (1932). For excellent histories of the evolution of the concept of the corporation, see William W. Bratton, Jr., *The New Economic Theory of the Firm: Critical Perspectives from History*, 41 Stan. L. Rev. 1471 (1989); David Millon, *Theories of the Corporation*, 1990 Duke L. J. 201; Eric W. Orts, Business Persons: A Legal Theory of the Firm (2013).

16. *See, e.g.*, Stephen Bainbridge, The New Corporate Governance in Theory and Practice (2008); Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 Harv. L. Rev. 833 (2005); Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 Va. L. Rev. 247 (1999).

ration announces a policy (believed by the market) to liquidate instead of invest, then the current stock value will be $100, reflecting the impending payment of the $100 in cash. If the corporation announces a policy (believed by the market) to invest in the project, then the current stock value will be $98, the expected value of the project. All of the risk-neutral shareholders will prefer liquidation, since $100 is more than the expected value of the project of $98.

What does Delaware law require of the directors of this simple Delaware corporation? In particular, does the law require the directors to liquidate the corporation and deliver $100 to the shareholders—a rule amounting to the maximization of current stock price, and the outcome that these posited risk-neutral shareholders would prefer? Or does the law require the directors to pursue the project, since there is a good chance (60 percent, more likely than not) that doing so will deliver to the shareholder a return that is higher than the current stock price, even though none of the existing risk-neutral shareholders would choose it? Or does the law allow the directors to make either decision, without fear of second guessing by the courts?

Note that it does not matter whether a shareholder wants out today or tomorrow. If the corporation is committed to the investment, then a shareholder who wants out today can sell his claim to another risk-neutral investor for his share percentage of $98, the expected value of the project. That share percentage of $98 is exactly the expected value faced by the shareholder who intends to hold his claim until tomorrow. Nor is a "short-term" shareholder leaving money on the table if he wants liquidation today. While it is true that the long-term investment may pay off at $110, it is also true that it may pay off at $80. A rational valuation (i.e., the expected value in this example) makes short-termism the value-maximizing strategy.

While this is a simple example, my judgment is that current law would allow the Delaware directors to choose either strategy.[17] They could choose the liquidation strategy on the rationale that it is, after all, the value-maximizing strategy and the strategy that shareholders would prefer. They also could choose the long-term investment strategy on the rationale that, while it does not maximize current share value, it does deliver a better-than-even chance of a 10 percent in-

17. It seems unlikely, for example, that the scenario could be challenged under the stringent definition of corporate waste, which requires that no reasonable person of good faith would have approved the transaction as fair. *See, e.g.*, Amalgamated Bank v. Yahoo! Inc., 132 A.3d 752, 784 (Del. Ch. 2016) ("Corporate waste occurs when a corporation is caused to effect a transaction on terms that no person of ordinary, sound business judgment could conclude represent a fair exchange." (quoting Steiner v. Meyerson, Civ. A. No. 13139, 1995 WL 441999, at *1 (Del. Ch. July 19, 1995))); Espinoza v. Zuckerberg, 124 A.3d 47, 67 (Del. Ch. 2015) ("[W]aste entails an exchange of corporate assets for consideration so disproportionately small as to lie beyond the range at which any reasonable person might be willing to trade." (quoting Lewis v. Vogelstein, 699 A.2d 327, 336 (Del. Ch. 1997))); Harbor Fin. Partners v. Huizenga, 751 A.2d 879, 901 (Del. Ch. 1999) ("The test for waste is whether any person of ordinary sound business judgment could view the transaction as fair."); *see also* Harwell Wells, *The Life (and Death?) of Corporate Waste*, 74 WASH. & LEE L. REV. (forthcoming 2017) (arguing demise of the waste doctrine in Delaware). Here, the possible upside could justify the transaction for a reasonable person not limited by maximizing present shareholder wealth.

crease in value (remember, by assumption true interest rates are 0 percent) and a remaining—less than even—chance of a loss of only 25 percent.

II. A Sketch of the Case that "Long Term" Equals "Longevity"

My argument is that Delaware law surreptitiously raises corporate longevity goals over value-maximization goals. Admittedly, I am offering preliminary hypothesis requiring more analysis. I do believe, however, that the prima facie case is suggestive that this is an idea worth more thought.

A. The Short-Term Argument Is Unsound

It is difficult—if not impossible—in the framework of modern financial economics to generate a logical argument (i.e., a model) for how a short-term gain can be larger than a properly valued larger longer-term gain that would otherwise be available, keeping constant risk and the like. After all, shareholders, it seems, care about risk-adjusted wealth, and want more of it rather than less. That is why financial economists, as a rule, do not take the short-termism assertion seriously. It assumes a level of investor irrationality that the facts cannot bear. As one reputable financial economist puts it, while there exists the view that "executives have the long-term interest of their corporation at heart, while shareholders, who can trade in and out, are only interested in short term results . . . I do not know of any empirical support for this view."[18]

The basic logic of the simple objection to the existence of short-termism has been falling on deaf ears in boardrooms, legal academia, and the courts for decades despite some legal scholars' best efforts to make the point simply and clearly. Professor Jonathan Macey stated, almost thirty years ago, "[t]he point, of course, is that the distinction between maximizing firm value for the present versus maximizing firm value for the future is wholly false. What matters in determining the value of a firm's shares is the present value of all flows—present and future."[19] Or as then-Professors Easterbrook and Fischel put it more than thirty years ago, "[i]f the market perceives that management has developed a successful long-term strategy, this will be reflected in higher share prices."[20]

The short-term/long-term complainants rarely try to provide a compelling response for why myopic shareholders would ignore the money they could make by waiting for large gains in the future or why current share prices would not reflect those future gains. It is no answer to point to "myopia," behavioral finance, and potentially inefficient markets. The short-term/long-term argument too seriously contradicts the most basic financial economic principles like dis-

18. Luigi Zingales, *The Future of Securities Regulation*, 47 J. Acct. Res. 391, 415 (2009).
19. Jonathan R. Macey, *State Anti-Takeover Legislation and the National Economy*, 1988 Wis. L. Rev. 467, 481.
20. Frank H. Easterbrook & Daniel R. Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, Harv. L. Rev. 1161, 1183–84 (1981).

counting, risk, and view of market efficiency so uncontroversial that a Nobel prize-winning behavioral economist and the Supreme Court of the United States can live with it.[21]

B. Delaware Law Gives No Definition to the "Long-Run Interests of Shareholders"

As former Chancellor Allen put it, "[t]hus, broadly, directors may be said to owe a duty to shareholders as a class to manage the corporation within the law, with due care and in a way intended to maximize the long run interests of shareholders."[22] Vice Chancellor Laster puts it this way, "[m]ore concretely, the fiduciary relationship . . . required that the directors act prudently, loyally, and in good faith to maximize [the company's] value over the long-term for the benefit of its stockholders."[23] Former Chancellor Chandler writes, "[t]his course of action has been clearly recognized under Delaware law: directors, when acting deliberately, in an informed way, and in the good faith pursuit of corporate interests, may follow a course designed to achieve long-term value even at the cost of immediate value maximization."[24]

One recent commentator takes things even further, arguing that the Delaware corporation's ability to have perpetual existence should *mandate* long-term value concerns that extend into perpetuity.[25] That article has been cited supportively by the Delaware courts several times.[26] As Vice Chancellor Laster put it recently, citing the article, "[w]hen deciding whether to pursue a strategic alternative that would end or fundamentally alter the stockholders' ongoing investment in the corporation, the loyalty-based standard of conduct requires that the alternative yield value exceeding what the corporation otherwise would generate for stockholders over the long-term."[27]

But what is this "long-term" shareholder value? The courts never say. It is not a concept from financial economics. Does anyone have a coherent explanation for what it means, in economic terms? Or does it mean something else?

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21. *See* Halliburton Co. v. Erica P. John Fund, Inc., 134 S. Ct. 2398, 2410 (2014) ("Even the foremost critics of the efficient-capital-markets hypothesis acknowledge that public information generally affects stock prices." (citing Robert Shiller, *We'll Share the Honors, and Agree to Disagree*, N.Y. Times, Oct. 27, 2013, at BU6 ("Of course, prices reflect available information . . . .")).

22. TW Servs., Inc. v. SWT Acquisition Corp., Civ. A. No. 10427, 10298, 1989 WL 20290, at *7 (Del. Ch. Mar. 2, 1989).

23. *In re* Rural Metro Corp., 88 A.3d 54, 80 (Del. Ch. 2014), *decision clarified on denial of reargument sub nom. In re* Rural Metro Corp. Stockholders Litig., No. 6350-VCL, 2014 WL 1094173 (Del. Ch. Mar. 19, 2014).

24. Air Prod. & Chems., Inc. v. Airgas, Inc., 16 A.3d 48, 124–25 (Del. Ch. 2011) (internal quotation omitted).

25. Andrew A. Schwartz, *The Perpetual Corporation*, 80 Geo. Wash. L. Rev. 764, 767 (2012) ("In theory, then, corporations should act as immortal investors.").

26. Virtus Capital L.P. v. Eastman Chem. Co., Civ. A. No. 9808-VCL, 2015 WL 580553, at *16 (Del. Ch. Feb. 11, 2015); *In re* Rural/Metro Corp. Stockholders Litig., 102 A.3d 205, 254 (Del. Ch.), *appeal dismissed sub nom. In re* Rural Metro Corp. S'holders Litig., 105 A.3d 990 (Del. 2014); *In re* Orchard Enters., Inc. Stockholder Litig., 88 A.3d 1, 36 (Del. Ch. 2014); *In re* Trados Inc. S'holder Litig., 73 A.3d 17, 38 (Del. Ch. 2013).

27. *In re* Trados Inc. S'holder Litig., 73 A.3d 17, 37 (Del. Ch. 2013) (citing Schwartz article).

C. Chief Justice Strine's Recent Commentary Suggests a Strong Concern with Corporate Sustainability

We get some possible clues as to the meaning of the long term in Delaware corporate law from recent commentary by Chief Justice Strine. There, something more is added to the mere assertion of the "long-term" interests of shareholders. Consider the following statements:

> The rights given to stockholders to make proposals and vote on corporate business are premised on the theory that stockholders have an interest in increasing the *sustainable* profitability of the firm.[28]

> In sum, real investors want what we as a society want and we as end-user, individual investors want; which is for corporations to create *sustainable* wealth.[29]

> [T]o foster *sustainable* economic growth, stockholders themselves must act like genuine investors, who are interested in the creation and *preservation* of long-term wealth, not short-term movements in stock prices.[30]

> The focus of many . . . institutions on quarterly earnings and other short-term metrics is fundamentally inconsistent with the objectives of most of their end-user investors, people saving primarily for two purposes, to put their kids through college and to fund their own retirements. These end-user investors do not care about quarterly earnings or short-term gimmicks. These end-user investors want corporations to produce *sustainable* wealth that will be there when they need it.[31]

Put simply, Chief Justice Strine wants corporate boards "to strike the proper balance between the pursuit of profits through risky endeavors and the prudent *preservation* of value."[32] In this he is with former Chancellor Allen, who comments that "it can be seen that the proper orientation of corporation law is the *protection* of long-term value of capital committed indefinitely to the firm."[33] But these are not the words of shareholder maximization; these are the words of longevity, of survivability. "Sustainable" and "Protection" are words more commonly heard in advocacy for environmental causes and natural resources, not shareholder interests. And there is good reason for that. Chief Justice Strine's view of shareholder interests is not fully convincing.

D. Real (Diversified) Shareholders Do Not Value Longevity This Way

Defending his conception of the long term, Chief Justice Strine points out that we should consider the goals of the end-user investor. These are people who

28. Leo E. Strine, Jr., *One Fundamental Corporate Governance Question We Face: Can Corporations Be Managed for the Long Term Unless Their Powerful Electorates Also Act and Think Long Term?*, 66 Bus. Law. 1, 8 (2010) (emphasis added).
29. *Id.* at 26 (emphasis added).
30. *Id.* (emphasis added).
31. *Id.* at 12 (emphasis added).
32. *Id.* at 18 n.54 (emphasis added).
33. William T. Allen, *Ambiguity in Corporation Law*, 22 Del. J. Corp. L. 894, 896–97 (1997).

"want corporations to produce sustainable wealth that will be there when they need it."[34] As Keynes put it, "[f]or that is what wealth is—command of the right to postponed consumption."[35] But there are two problems with moving from the premise that investors want wealth when they need it for consumption to the conclusion that investors want any *particular* corporation to be "sustainable." One problem is empirical. The other problem is logical.

Empirically, a view of corporations as properly managed to a sustained path of ever-upward profitability ignores the realities of corporate growth and decline. A much underemphasized empirical fact is that the best performing stocks in a broad index perform much better than the other stocks in the index, so that average index returns depend heavily on the relatively small set of winners. A recent study from J.P. Morgan is instructive:

> Studying the S&P 500 is useful, as it represents the largest, most successful companies in the U.S. We looked specifically at how many, and why, companies were removed from the index between 1980 and 2014. After setting aside the many deletions that were due to benign factors like mergers, companies being acquired at a premium, or re-incorporations outside the U.S., we focused on those companies that were removed due to business distress. What we found was that, over the past 35 years, there was a lot of 'creative destruction' taking place, with an estimated 320 companies removed for reasons of business distress. And while the rate does tend to pick up during recessions, there is a steady pulse of business failures even during periods of economic expansion. What this tells us is that companies, even very successful ones, face a steady drumbeat of competitive, regulatory and operational risks.[36]

The results are sobering. "When looking at how often a stock has what we call a 'catastrophic decline'—falling 70 percent or more and never recovering—we see that 40 percent of all stocks suffer this fate at some time in their history. And some sectors—like Telecom, Biotech, and Energy—saw higher-than-average loss rates."[37]

Thus, the empirical reality is that many stocks do poorly in the long run. This is likely a reason why "the modern law of trust investment has come to regard lack of diversification as close to a *per se* breach of fiduciary duty."[38] If the empirical facts teach us anything, it is that pushing off the day of corporate reckoning to the long run often will turn out poorly. "Sustainable profitability" is a tough goal, and we need to recognize that fact when setting the rules for directors of for-profit corporations. It may not be as bad for corporations as Keynes

34. Strine, *supra* note 28, at 12.

35. J.M. Keynes, *How to Pay for the War*, *in* ESSAYS IN PERSUASION 367, 393 (2010).

36. J.P. MORGAN, EYE ON THE MARKET, THE AGONY AND THE ECSTASY: THE RISKS AND REWARDS OF A CONCENTRATED STOCK POSITION (2014), https://goo.gl/8KCIM7.

37. *Id.* Indeed, my co-authors and I have argued elsewhere that this is one of the reasons that active money management is so difficult. *See* J.B. Heaton, Nick Polson & Jan Hendrik Witte, Why Indexing Works (Nov. 24, 2016) (unpublished manuscript available at https://goo.gl/U4Zlz3).

38. Jonathan Klick & Robert H. Sitkoff, *Agency Costs, Charitable Trusts, and Corporate Control: Evidence from Hershey's Kiss-Off*, 108 COLUM. L. REV. 749, 754 (2008).

said of people, that "in the long run we are all dead,"[39] but for many corporations, it gets pretty grim in the long run.[40] At a minimum, long-run superior performance is quite rare.[41]

Logically, it does not follow from the premise that investors invest for long-term wealth that investors want or expect the individual corporations in whose stock they invest to seek "the prudent preservation of value."[42] For rational investors who are well-diversified (index investors, say), what matters is the performance of their portfolio as a whole. Such investors do not value corporate longevity as an independent objective; they value wealth accumulation in the portfolio. Empirical evidence shows that corporations with more diversified controlling shareholders are more willing to take risks, generally considered by financial economists to be a good thing, since undiversified shareholders are more likely to forgo positive net present value projects.[43] If a corporation in the S&P 500 is more valuable by paying out excess cash flows, and those cash flows are reinvested in the index's higher growing components, then my kids' college educations and my retirement benefit. With apologies to Neil Young, it can be better for a stock in a diversified portfolio to burn out (profitably) than fade away (unprofitably).[44]

That is not to overlook the human costs of corporate decline, but to pretend that Delaware directors legally can sacrifice shareholder welfare for such concerns is to make exactly the mistake that Chief Justice Strine so cogently warns us about in a recent article.[45] Perhaps we should change corporate law

39. John M. Keynes, A Tract on Monetary Reform 80 (1923).

40. Of course, companies "die" all the time, and then the focus on longevity is no more. *See, e.g.*, Andrikopoulos v. Silicon Valley Innovation Co., 120 A.3d 19, 25 (Del. Ch. 2015) ("In the usual receivership context, however—and especially in receiverships like this one—there is no long-term horizon; the focus is on winding up the entity's affairs."), *aff'd*, 142 A.3d 504 (Del. 2016). Some older evidence on corporate mortality can be found in Maggie Queen & Richard Roll, *Firm Mortality: Using Market Indicators to Predict Survival*, 43 Fin. Analysts J. 9, 12 (1987) (for publicly listed firms between 1962 and 1985, "[a]bout one-quarter of the smallest firms are halted, delisted or suspended from trading within a decade, and about 5 percent actually meet this fate within one year. In contrast, less than 1 percent of the largest firms expire from unfavorable causes, even over the longest observation interval.").

41. *See* Nicholas G. Polson & James G. Scott, *Good, Great, or Lucky? Screening for Firms with Sustained Superior Performance Using Heavy-Tailed Priors*, 6 Annals Applied Stat. 161, 163 (2012) (finding that only 0.5 percent of firms show "moderately strong evidence of sustained superior performance over 5 years or more" over the period 1966–2008).

42. Strine, *supra* note 28, at 18 n.54.

43. *See* Mara Faccio, Maria-Teresa Marchica & Roberto Mura, *Large Shareholder Diversification and Corporate Risk-Taking*, 24 Rev. Fin. Stud. 3601, 3605 (2011) ("diversification (at the shareholder portfolio level) is conducive to more corporate risk-taking," which is desirable because "well-diversified controlling shareholders are likely to invest in all positive NPV projects, regardless of these projects' riskiness").

44. For alternative views of the role of diversification in corporate objections, see, for example, Richard A. Booth, *Stockholders, Stakeholders, and Bagholders*, 53 Bus. Law. 426 (1998) (arguing that directors may want to manage from the perspective of the undiversified shareholder, and not the diversified shareholder).

45. Strine, *supra* note 5, at 768 ("But lecturing others to do the right thing without acknowledging the actual rules that apply to their behavior, and the actual power dynamics to which they are subject, is not a responsible path to social progress."). For one particularly candid view by corporate stakeholder advocates of the ease of hiding other agendas behind long-term shareholder wealth maximi-

and other laws to deal better with corporate decline and its human cost. My point here is not otherwise, and I am personally sympathetic to that line of reasoning. But we should not pretend that smart shareholders (*qua* shareholders trying to accumulate wealth for consumption) prefer something they do not and claim that we are doing them a favor by subordinating their true interests to imaginary (or at least excessively speculative) "long-term" benefits.

III. Longevity and the Stakeholders

Assuming I have made a prima facie case that the "long-term" interests of shareholders in corporate law means something more like longevity of the entity, why should that be? The answer, I believe, is that longevity, under guise of long-term shareholder interests, allows courts and directors to watch out for other interests—stakeholder interests—without having to admit to doing so. In the words of one commentator, "[i]t can be argued that maximizing the financial interests of shareholders is the core duty of directors, but if the corporation is viewed as a social entity and not simply a property conception, one can, and the courts have, justified deferring immediate gain for long-term welfare."[46] To this extent, the "long term" rhetoric is simply a way of bringing back to life a concern with non-shareholder constituencies about which commentators have long debated.[47] In modern times, Martin Lipton and Steven A. Rosenblum wrote in 1991 that "the legal rules, the system of corporate governance, should encourage the ordering of these relationships and interests around the long-term operating success of the corporation. For it is this goal that will ultimately be the most beneficial to the greatest number of corporate constituents, including stockholders, and to our economy and society as a whole."[48] Very recently, Chief Justice Strine has written an article in nearly the same language:

> Why can't we, people ask, have corporations focus on the creation of sustainable wealth, by engaging in fundamentally sound and sustainable business investment and operations? And by doing that, create jobs that investors, their children, and grandchildren can have to live well. By that means, end-user investors will have the main thing they really need, which is a good job. And they will also have a solid investment portfolio to provide for themselves in retirement and to pay for

zation rationales, see Richard Marens & Andrew Wicks, *Getting Real: Stakeholder Theory, Managerial Practice, and the General Irrelevance of Fiduciary Duties Owed to Shareholders*, 9 Bus. Ethics Q. 273, 281 (1999) ("No competent attorney would allow her client to argue in court that their corporation made a decision because it 'was the right thing to do' in the face of evidence that management knew of legal alternatives whose impact on the bottom line, short term and long term, were indisputably superior. It may smack of moral cowardice, but given the uncertainty of what sustains and makes a business profitable over a period of years, virtually any act that does not financially threaten the survival of the business could be construed as in the long-term best interest of shareholders.").

46. Jospeh T. Walsh, *The Fiduciary Foundation of Corporate Law*, 27 J. Corp. L. 333, 337 (2002).

47. *See, e.g.*, sources cited at *supra* note 15.

48. Martin Lipton & Steven A. Rosenblum, *A New System of Corporate Governance: The Quinquennial Election of Directors*, 58 U. Chi. L. Rev. 187, 189 (1991).

> their kids' education. Wouldn't we all be a winner, they ask, with this sort of alignment?[49]

He has similarly taken the leading shareholder rights legal academic, Lucian A. Bebchuk, to task; Bebchuk, the Chief Justice writes, "reductively focuses on equity returns, [and] blinds himself to any consideration of externality effects or the larger economic outcomes of the American economy for its citizens."[50]

The connection between such a view of the long term and stakeholders is not occurring just in academic corporate law; it is extending to fiduciary duties governing investment management. A group of investors, executives, and consultants calling themselves Focusing Capital on the Long Term met in March 2015 to discuss investor myopia. Laurence Fink, one of the co-chairs of the group and the founder of the world's largest asset manager BlackRock Inc., spoke at the meeting.

> Among the topics Mr. Fink raised at the meeting . . . was whether changes should be made to the definition of fiduciary duty—the requirement that investment managers are beholden to seek to grow their clients' money above all else. Mr. Fink wanted discussion about whether the definition could expand to give leeway to fund managers to think about topics like job creation or the environment when making decisions. He said he didn't know the answer.[51]

Conclusion

I have proposed that the "long-term" interests of shareholders in corporate law may be masking emphasis on corporate longevity, and that this emphasis may not be in the interests of shareholder welfare, at least as much or in the way presented by courts and commentators. It is surprising in the first place that the long term should have such a privileged position in things so unpredictable as shareholder welfare, business, and the economy. Prediction is hard, and those domains are no different. If shareholder welfare really was the bottom-line concern of Delaware law, one could easily imagine a sensible rule that *subordinated* long-term concerns to shorter-term estimates of value, especially where sophisticated financial markets provide market-based judgments on (public) corporations almost every day. The simple fact of discounting future cash flows to the present already means that the distant cash flows have less impact on today's value.[52] There may be good reasons that risk perceptions are different over

49. Leo E. Strine, Jr., *Securing Our Nation's Economic Future: A Sensible, Nonpartisan Agenda to Increase Long-Term Investment and Job Creation in the United States*, 71 Bus. Law. 1081, 1082–83 (2016).

50. Leo E. Strine, Jr., *Can We Do Better by Ordinary Investors? A Pragmatic Reaction to the Dueling Ideological Mythologists of Corporate Law*, 114 Colum. L. Rev. 449, 462 (2014).

51. David Benoit, *BlackRock's Fink, McKinsey Lead Group Fighting Wall Street Myopia*, Wall St. J. (Mar. 11, 2015, 2:20 PM EST), http://blogs.wsj.com/moneybeat/2015/03/11/blackrocks-fink-mckinsey-lead-group-fighting-wall-street-myopia/.

52. *See* Jesse M. Fried, *The Uneasy Case for Favoring Long-Term Shareholders*, 124 Yale L.J. 1554, 1575 n.85 (2015) ("Because of the need to discount for the time value of money and risk, future cash flows are less valuable in present dollar terms than are current cash flows. So the long term might be the future point in time when the present value of the cash flow becomes immaterial."). Perhaps one

the short term than over the long term,[53] and cognitive biases like managerial optimism may come into play differently over different horizons as well.[54] We can certainly find examples of corporations that Delaware law protected, only to see the corporation fail in the long run. Polaroid comes to mind.[55] But those are just anecdotes. The role of the "long-run" shareholder interest in corporate law—whether it means longevity as I have proposed here and, if so, who that longevity is really serving—deserves more study. It is having a large impact on current debates on hedge fund activism, for example, and perhaps it is impacting more that we are not noticing as well.

interesting avenue to explore is the idea that Delaware courts value the long term at lower discount rates than shareholders demand, akin to the intergenerational discounting often at issue in debates over natural resources and the environment. *See, e.g.*, Cass R. Sunstein & Arden Rowell, *On Discounting Regulatory Benefits: Risk, Money, and Intergenerational Equity*, 74 U. CHI. L. REV. 171 (2008) (discounting problems of intergenerational fairness and discounting).

53. *See, e.g.*, Jamil Baz et al., *Risk Perception in the Short Run and in the Long Run*, 10 MARKETING LETTERS 267 (1999) (analyzing how risk perception may differ depending on time horizon).

54. *See, e.g.*, Michal Barzuza & Eric L. Talley, *Short-Termism and Long-Termism* (Va. Law & Econ. Research Paper No. 2, 2016), https://goo.gl/f744zD; *see also* J.B. Heaton, *Managerial Optimism and Corporate Finance*, 31 FIN. MGMT. 33 (2002).

55. As the chancery court wrote:

> Because of the nature of its business, Polaroid has always devoted a significant portion of its resources to research and development. Although the technological advances generated by this work sometimes lead to successful commercial products, that is not always the case. In addition, it may take years of research and development before a new product is introduced and begins generating income. In short, research and development cuts into Polaroid's short term profits but provides the basis for anticipated long term growth.

Shamrock Holdings, Inc. v. Polaroid Corp., 559 A.2d 257, 260 (Del. Ch. 1989) (upholding the use of a defensive employee stock ownership program). Polaroid went bankrupt twelve years later in 2001.