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Conceptions of Corporate Purpose in Post-Crisis Financial Firms

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I. INTRODUCTION

American "populism" has had a major impact on the development of U.S. corporate governance throughout its history. Specifically, appeals to the perceived interests of average working people have exerted enormous social and political influence over prevailing conceptions of corporate purpose—that is, the aims toward which society expects corporate decision-making to be directed. In this Article, I assess the impact of American populism upon prevailing conceptions of corporate purpose, contrasting its unique expression in the context of financial firms with that arising in other contexts. I then examine its impact upon corporate governance reforms enacted in the wake of the financial and economic crisis that emerged in 2007.

In Part II, I explore how populism has historically shaped conceptions of corporate purpose in the United States. I begin with non-financial firms, arguing that corporate law has long remained ambivalent regarding the consistency of shareholders' interests and incentives with those of the broader public. The unique vulnerabilities of U.S. employees relative to their counterparts in otherwise similar common law countries have historically heightened this ambivalence. The consequence has been substantial social and political pressure to constrain the power of U.S. shareholders and to diminish their formal centrality to the corporate enterprise, toward the aim of enhancing firm sustainability.

I contrast these dynamics with those observed in the context of financial firms, where U.S. misgivings regarding shareholders have historically been even greater, reflecting not only the economic significance of

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financial firms, but also recognition of their shareholders' greater inclination toward risk-taking. While the "employee" conceptual category best encapsulates the perceived interests of average working people in the non-financial context, the "depositor" conceptual category best encapsulates their perceived interests in the financial context. Accordingly, American populism has long fostered strong emphasis on the interests of bank depositors, resulting in remarkable corporate architectural strategies aimed at ensuring firm sustainability in order to insulate depositors from destabilizing social and economic shock. While foreclosing hostile takeovers has provided the clearest legal expression of populist pressure to prioritize firm sustainability over shareholder interests in the non-financial context, foreclosing excessive risk-taking has provided its clearest expression in the financial context—a goal historically pursued not only through prudential regulation, but also by imposing heightened fiduciary duties on directors and personal liability on shareholders.

In Part III, I turn to the crisis, arguing that growing shareholder centrism over recent decades goes a long way toward explaining excessive risk-taking in financial firms—a conclusion rendering post-crisis reforms aimed at further strengthening shareholders a surprising and alarming development. While many have observed that the inherent challenges of financial-firm management have grown substantially as financial firms and their products alike have grown larger, more complex, and increasingly opaque, far fewer have acknowledged that corporate architectural strategies that historically constrained risk-taking in U.S. banks were effectively marginalized, or discarded entirely, in parallel with those developments. The trend over recent decades toward full-service financial firms with publicly traded stock has placed greater emphasis on generating returns for financial firm shareholders while simultaneously blurring corporate law's historical distinction between financial and non-financial firms. The results have been stronger incentives to engage in financial risk-taking and a weaker capacity to limit it through corporate law.

Our increasingly shareholder-centric conception of the purpose of financial firms has greatly constrained our sense of the possible in the wake of the crisis. While traditional American populism has remained a powerful political force, it has expressed itself differently in this new environment, fueling a post-crisis narrative that has actually facilitated shareholder empowerment not only in today's highly diversified financial mega-firms, but in all public companies. Widespread outrage over managerial recklessness dovetailed with populist sympathy for hard-hit "middle class" working families, effectively merging traditional "shareholder" and "employee" concerns regarding the stability of retirement funds and job-linked social welfare benefits into a powerful anti-manager political coalition.

That post-crisis populism would express itself in shareholder-centric corporate governance reforms demonstrates just how narrow and ossified our sense of corporate purpose has become and the degree to which we have lost sight of the relationship between limited liability and risk-taking in corporate governance. Armed with a diminished vocabulary for describing the relationship between corporate governance and financial risk—and correlatively, a much smaller conceptual toolbox for constraining excessive risk-taking through corporate law—we have found ourselves unable to tackle a set of problems requiring the ability to think creatively about how the corporate architecture ought to be structured. The result has been a crisis narrative and corresponding corporate governance reforms that not only fail to acknowledge the role of equity market pressures toward excessive risk-taking in financial firms, but also reinforce such pressures moving forward.

I conclude in Part IV that the potential corporate governance reforms most worthy of consideration include those aimed at accomplishing precisely the opposite: insulating financial-firm management from equity-market pressures and associated risk incentives. This may well require resurrecting corporate architectural strategies embraced in the past. Notably, such strategies include imposing more robust fiduciary duties upon financial firm directors, while at the same time imposing some measure of personal liability for financial firm losses upon the shareholders themselves—including directors, officers, and employees receiving equity-based pay. As a threshold matter, however, we must first grapple effectively with a more fundamental and pressing social and political problem. Until we firmly combat the growing popular misconception that financial firms exist merely to maximize stock prices for the short-term benefit of their shareholders, we will at best fail to address the core problem, and at worst endure similar crises in the future.

II. American Populism and Corporate Purpose

Populism has long exerted substantial influence over U.S. corporate law—including prevailing conceptions of corporate purpose—but has manifested itself in different ways in financial and non-financial contexts, respectively. In this part of the Article, I contrast these differing manifestations of populism in U.S. corporate law, focusing particularly on remarkable corporate architectural strategies aimed at foreclosing excessive risk-taking in financial firms as a means of ensuring their sustainability.

A. Corporate Law's Ambivalence Regarding Shareholders

Ambivalence regarding corporate purpose—most notably with respect to the governance role of shareholders and the centrality of their interests in corporate decision-making—has long been a defining feature of U.S. corporate law.[1] Undoubtedly, the core governance structure of the corporation favors shareholders over other corporate stakeholders in real and meaningful ways. For example, in Delaware (the jurisdiction of incorporation for most U.S. public companies),[2] it is the shareholders who are empowered to elect the board of directors,[3] to ratify charter amendments and fundamental transactions,[4] and to advance corporate claims in certain circumstances through so-called "derivative" suits.[5] Shareholders even possess some (unspecified) degree of unilateral power to alter governance rules through the corporation's bylaws.[6]

Notwithstanding their special status, however, a number of aspects of U.S. corporate law cast doubt on the claim that the corporation's singular purpose is to maximize shareholder wealth. Under the business judgment rule, courts generally will not second-guess unconflicted business decisions. As the Delaware Supreme Court has emphasized, "[c]ourts do not measure, weigh or quantify directors' judgments . . . . Due care in the decisionmaking context is *process* due care only. Irrationality is the outer limit of the business judgment rule."[7] This hands-off posture effectively gives the board of directors substantial discretion to deviate from strict shareholder centrism in day-to-day business affairs, as

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1. *See generally* Christopher M. Bruner, *The Enduring Ambivalence of Corporate Law*, 59 ALA. L. REV. 1385 (2008).

2. *See* Del. Div. of Corps., *Why Choose Delaware as Your Corporate Home?*, STATE OF DELAWARE, http://corp.delaware.gov/ (last updated Jan. 2, 2013).

3. DEL. CODE ANN. tit. 8, § 211(b) (West 2009).

4. *Id.* §§ 242(b) (charter amendments), 251(b)–(c) (mergers), 271(a) (sales of substantially all assets).

5. *See* Tooley v. Donaldson, Lufkin & Jenrette, Inc., 845 A.2d 1031, 1036 (Del. 2004) (explaining that the derivative suit "enables a stockholder to bring suit on behalf of the corporation for harm done to the corporation"); *see also* N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla, 930 A.2d 92, 102–03 (Del. 2007) (holding that creditors have derivative standing only once the corporation is insolvent).

6. DEL. CODE ANN. tit. 8, § 109 (West 2009). On the shareholders' murky authority to enact, amend, and repeal bylaws, see generally Christopher M. Bruner, *Managing Corporate Federalism: The Least-Bad Approach to the Shareholder Bylaw Debate*, 36 DEL. J. CORP. L. 1 (2011).

7. Brehm v. Eisner, 746 A.2d 244, 264 (Del. 2000); *see also* Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984) (describing the business judgment rule as "a 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 interests of the company"), *overruled on other grounds by* Brehm v. Eisner, 746 A.2d 244 (Del. 2000).

a growing body of scholarship has recognized.[8] That discretion, then, is strongly reinforced by corporate statutes rendering it relatively difficult to remove U.S. directors. Unlike in the United Kingdom, where public company shareholders with five percent voting power can call meetings and directors can be removed by ordinary resolution of a simple majority,[9] Delaware shareholders possess no default power to call meetings and, if the board has been "staggered" into multiple classes (elected in successive years), cause is required to remove directors unless the charter provides otherwise.[10]

Most revealingly, however, U.S. boards are given explicit discretion to deviate from the shareholders' interests in the context where they most sharply diverge from those of other stakeholders: hostile-takeover bids. Many states have adopted "other constituency" statutes permitting boards to bring the interests of employees, creditors, and other stakeholders to bear in determining how to respond to a hostile takeover bid.[11] Delaware is not among them, but the Delaware courts have nevertheless constructed an elaborate case law giving target boards substantial discretion to employ defensive measures, including by reference to the interests of non-shareholder constituencies.[12] While the Delaware Supreme Court has imposed a duty to maximize short-term returns to shareholders in a sale, break-up, or change of control,[13] this duty is in fact quite limited; whether there is to be a sale, break-up, or change of control is itself largely within the target board's discretion. Critically, it is the board's prerogative to determine the timeframe for the pursuit of corporate strategy, which permits a target board to maintain takeover defenses as a means of safeguarding its own long-term strategy for the company, even where this flies in the face of the shareholders' clear wishes.[14]

To be sure, a strong emphasis on generating returns for shareholders has increasingly animated U.S. corporate governance (a tendency to

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8. *See, e.g.*, Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 299–309 (1999); Bruner, *supra* note 1, at 1402, 1411–12, 1424–27; Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733, 770–75 (2005).

9. Companies Act, 2006, c. 46, §§ 168, 282, 303, 304 (U.K.).

10. DEL. CODE ANN. tit. 8, §§ 141(d), 141(k)(1), 211(d) (West 2009). For a comparison of the U.S. corporate governance regime with the considerably more shareholder-centric U.K. regime, see generally Christopher M. Bruner, *Power and Purpose in the "Anglo-American" Corporation*, 50 VA. J. INT'L L. 579 (2010).

11. *See* Bruner, *supra* note 1, at 1420–21.

12. *See* Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 954–55 (Del. 1985).

13. *See* Revlon, Inc. v. MacAndrews & Forbes Holding, Inc., 506 A.2d 173, 182 (Del. 1986); Paramount Commc'ns Inc. v. QVC Network Inc., 637 A.2d 34, 43–44 (Del. 1994).

14. *See* Paramount Commc'ns, Inc. v. Time Inc., 571 A.2d 1140, 1149–55 (Del. 1990). For additional discussion of Delaware's approach to hostile takeovers, see Bruner, *supra* note 1, at 1415–18; Bruner, *supra* note 10, at 596–99.

which I return below).[15] It does so, however, as a market norm, not a legal rule. As Lynn Stout has aptly put it, shareholder centrism is "an ideology, not a legal requirement or a practical necessity of modern business life."[16] In the United States, shareholder-wealth maximization is, at most, a heuristic aid to corporate decision-making—a proxy for the public good. But to say this is to suggest that it can be displaced by reference to some other norm. While U.S. corporate law remains notoriously ambiguous on this point, the case law (including in Delaware) suggests a more fundamental norm that trumps shareholder-wealth maximization when these norms directly conflict: sustainability of the corporate enterprise.[17] This is why, for example, boards are empowered to maintain defenses in hostile-takeover bids. When push comes to shove, sustaining the enterprise for the good of all stakeholders has been deemed more important than generating premiums for shareholders.

The degree to which U.S. corporate law empowers boards to prioritize sustainability becomes clearer when this approach is set beside that embraced in other countries, including those with which we have the strongest legal, economic, and cultural ties. The U.S. corporate governance regime differs quite markedly from those of Australia, Canada, and the United Kingdom, all of which expressly place greater emphasis on shareholders' interests, and give shareholders substantially more governance power than we do. While there are numerous potential explanations for the greater shareholder centrism of these other common law jurisdictions, a critical factor driving this divergence is the complex interaction of corporate law with other regulatory fields that affect the interests of other corporate stakeholders. Just as corporate law affects the internal organization of corporations, the broader political economy affects the internal organization of corporate law. It is through this lens that our greater ambivalence regarding shareholders begins to come into focus.[18]

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15. *See infra* Parts III–IV.

16. LYNN STOUT, THE SHAREHOLDER VALUE MYTH: HOW PUTTING SHAREHOLDERS FIRST HARMS INVESTORS, CORPORATIONS, AND THE PUBLIC 3 (2012); *see also* Elhauge, *supra* note 8, at 738 ("None of the fifty states has a statute that imposes a duty to profit-maximize or that makes profit-maximization the sole purpose of the corporation."). This again contrasts starkly with U.K. company law, which expressly favors the shareholders' interests by statute. *See* Companies Act, 2006, c. 46, § 172 (U.K.).

17. *See* Bruner, *supra* note 1, at 1427–32; *see also* Simon Deakin, *The Corporation as Commons: Rethinking Property Rights, Governance and Sustainability in the Business Enterprise*, 37 QUEEN'S L.J. 339, 367–80 (2012) (characterizing the corporation as a "commons," with various areas of law, including corporate law, at once "specifying the conditions under which various contributors of inputs . . . can draw on the resources of the firm while at the same time preserving and sustaining the firm's asset pool as a source of productive value").

18. For a detailed comparative study of social and political drivers leading the United States and the United Kingdom to diverge in this manner, see generally Bruner, *supra* note 10. For a broader comparative study of the U.S. divergence from the more shareholder-centric approaches of Aus-

The United Kingdom, for example, has long embraced a takeover regime giving shareholders near-total control over the success or failure of hostile bids—an approach substantially expanded and reinforced in the 1960s under a Labour government, notwithstanding the apparent tension with the interests of the Labour Party's core constituency. As I have argued elsewhere, this development reflected the belief among Labour leaders at that time that industrial consolidation through takeovers would improve Britain's international competitiveness and that the post-war welfare state and labor law protections were sufficient to buffer the downsides for employees. In other words, takeovers appeared to offer substantial benefits at manageable costs given Britain's economic circumstances and broader regulatory framework at the time. Conversely, the United States adopted a stakeholder-centric takeover regime in the 1980s, during the ascendance of the modern political right. This development reflected the fact that, unlike in 1960s Britain, takeovers were not widely viewed in 1980s America as offering broader social and economic benefits. Additionally, social welfare and labor law protections were not deemed sufficient to buffer the downsides for American employees, who, unlike their British counterparts, stood to lose their access to healthcare and other job-linked social welfare benefits should they be fired in a subsequent consolidation. Thus, because takeovers appeared to offer minimal benefits at unmanageable costs (reflecting our own unique political economy and the unique social and political consequences of strongly favoring shareholder interests in the United States), we constrained such transactions, and the shareholders' governance power more generally, through corporate law.[19]

B. Heightened Ambivalence Regarding Financial Firm Shareholders

To this point, I have ascribed U.S. corporate law's ambivalence regarding shareholders primarily to social and political concerns for the welfare of other constituencies—dynamics most vividly reflected in the degree to which U.S. courts and legislatures have empowered boards to sustain the corporate enterprise as a means of insulating vulnerable employees, in particular, from the destabilizing effects of corporate consolidation. This argument would appear to fit quite comfortably with certain types of corporate enterprises, like manufacturers with large work forces

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tralia, Canada, and the United Kingdom, see CHRISTOPHER M. BRUNER, CORPORATE GOVERNANCE IN THE COMMON-LAW WORLD: THE POLITICAL FOUNDATIONS OF SHAREHOLDER POWER (forthcoming 2013).

19. *See* Bruner, *supra* note 10, at 621–43; *see also* BRUNER, *supra* note 18, ch. 5 (further describing these divergent social and political conditions and detailing Australian and Canadian social welfare dynamics broadly resembling those in the United Kingdom).

heavily invested in firm-specific (and thus relatively immobile) skills.[20] But what about financial firms, which do not fit this description,[21] yet raise unique social and political concerns of their own? As I describe below, issues of corporate purpose have arisen in a related, though distinct, manner in the context of financial firms, where our ambivalence regarding shareholders has, if anything, historically been even greater than in non-financial contexts.[22]

One of the first intriguing insights to arise in the wake of the 2007 financial crisis was the realization that, as recently as 2009, the empirical literature on corporate governance in financial firms was quite thin.[23] This is surprising because courts and regulators have long viewed corporate governance in banks differently and for good reasons. As a threshold matter, the economic role of these firms differs. Banks and other financial firms perform a capital-allocation function that is central to the efficiency of a capitalist economy. Accordingly, the social and economic stakes of their governance, and the costs of their failure, are quite high.[24] Thus it is hardly surprising that U.S. courts and regulators have long taken a keen interest in bank governance, even going so far as to characterize them as "quasi public institutions."[25]

The differing nature of these firms also introduces unique governance challenges. Fundamentally, banks are in the business of "maturity transformation," making short-term money useful for long-term purposes. This critically important financial function is also an inherently unstable one because the balance-sheet mismatch between long-term assets and short-term liabilities naturally leaves them vulnerable to "bank

20. Recall that such concerns have motivated criticism of hostile takeovers. *See generally* Andrei Shleifer & Lawrence H. Summers, *Breach of Trust in Hostile Takeovers, in* CORPORATE TAKEOVERS: CAUSES AND CONSEQUENCES (Alan J. Auerbach ed., 1988). Legal structures empowering the board to sustain the corporate enterprise have likewise prompted "team production" theorists' conceptualization of the board as a "mediating hierarch" empowered to prevent various stakeholders making firm-specific investments from exploiting one another. *See generally* Blair & Stout, *supra* note 8.

21. *See* STOUT, *supra* note 16, at 84–85 ("Nor do finance employees invest much in firm-specific human capital. Goldman Sachs investment bankers and Morgan Stanley traders can easily take their skills and their client relationships to other banks, and often do . . . .").

22. *See infra* Part II.C.2.

23. *See* Renée Adams, *Governance and the Financial Crisis* 5 (Eur. Corp. Governance Inst., Finance Working Paper No. 284/2009, 2009), *available at* http://ssrn.com/abstract=1398583 (recognizing the limitations of the extant literature); Luc Laeven & Ross Levine, *Bank Governance, Regulation and Risk Taking*, 93 J. FIN. ECON. 259, 259 (2009) (same); *see also* Renée Adams & Hamid Mehran, *Is Corporate Governance Different for Bank Holding Companies?*, 9 ECON. POL'Y REV. 123, 123 (2003) (same); Jonathan R. Macey & Maureen O'Hara, *The Corporate Governance of Banks*, 9 ECON. POL'Y REV. 91, 91 (2003) (same).

24. *See, e.g.*, Adams & Mehran, *supra* note 23, at 124; BASEL COMM. ON BANKING SUPERVISION, PRINCIPLES FOR ENHANCING CORPORATE GOVERNANCE 1 (2010).

25. *See, e.g.*, Campbell v. Watson, 50 A. 120, 124 (N.J. Ch. 1901).

runs."[26] The fact that financial risk is their very stock-in-trade renders their assets and liabilities particularly abstract and difficult to value.[27]

As a consequence of their distinct nature and economic role, the relevant corporate stakeholders in banks have long been conceptualized differently as well. While banks have boards, officers, employees, shareholders, and creditors just like other types of corporate entities, banks also have a unique category of creditors thought to alter the governance equation in a fundamental way–depositors. Unlike typical creditors, bank depositors are poorly positioned to monitor bank governance for at least a few reasons. Depositors often lack the financial sophistication and information required to monitor effectively—a problem exacerbated by the complex and abstract nature of a bank's assets and liabilities. Moreover, the advent of deposit insurance, directed at resolving the problem of bank runs, further undermines depositors' monitoring incentives because they know that they are covered no matter what becomes of the bank in question.[28] The analogue of this moral hazard problem for non-bank financial firms is, of course, the "too big to fail" problem—in which implicit government guarantees through bailouts undermine monitoring incentives in a manner closely resembling that of deposit insurance in commercial banks.[29]

The upshot is that while we have traditionally envisioned corporate creditors as sophisticated parties well-positioned both to protect themselves contractually and to provide robust monitoring of management's performance, in financial firms—and particularly banks—we have traditionally envisioned exactly the opposite. Depositors have historically been characterized as ordinary people who lack financial sophistication

26. *See* Christopher M. Bruner, *Corporate Governance Reform in a Time of Crisis*, 36 J. CORP. L. 309, 311–12 (2011); Macey & O'Hara, *supra* note 23, at 97; Jonathan R. Macey & Maureen O'Hara, *Solving the Corporate Governance Problems of Banks: A Proposal*, 120 BANKING L.J. 326, 326 (2003).

27. *See* GROUP OF THIRTY, TOWARD EFFECTIVE GOVERNANCE OF FINANCIAL INSTITUTIONS 46 (2012) ("Financial risk of some form, or a means of hedging it, is a key ingredient of every service or product offered by . . . [a financial institution], a characteristic that distinguishes . . . [financial institutions] from other types of business."); Stephen M. Bainbridge, *Caremark and Enterprise Risk Management*, 34 J. CORP. L. 967, 982 (2009) ("Devising effective enterprise risk management programs has been a particular challenge for the board of directors of 'complex risk-taking organizations such as banks, securities firms, insurance companies, and energy companies' . . . ."); Kristin N. Johnson, *Addressing Gaps in the Dodd-Frank Act: Directors' Risk Management Oversight Obligations*, 45 U. MICH. J.L. REFORM 55, 61–65 (2011) ("The business activities of financial institutions engender unique risk concerns. In addition to facing risks common to all businesses, the principal commercial activities of financial institutions also entail risks associated with sophisticated investment decisions."); Macey & O'Hara, *supra* note 26, at 326 (observing that, among other things, "the opacity of [bank] balance sheets" creates "unique challenges regarding corporate governance").

28. *See* Bruner, *supra* note 26, at 312; Macey & O'Hara, *supra* note 26, at 326–27.

29. *See* Bruner, *supra* note 26, at 315.

or otherwise remain poorly positioned to monitor bank management effectively[30]—hence the perceived need for regulators to serve as substitute monitors and to protect depositors from faithless or reckless managers.[31]

At the same time, however, this differing conceptualization of bank creditors has, in turn, led to a differing conceptualization of bank shareholders. Shareholders in any corporate entity naturally favor risk-taking more than other constituencies do because limited liability allows them to capture the upside while avoiding much of the downside.[32] Due to the peculiar monitoring problems described above, however, the shareholders' inclination toward risk has long been thought to be heightened in financial firms because an impediment to risk-taking has effectively been removed, resulting in correlatively greater concerns among judges and legislators alike regarding pressure from shareholders to engage in riskier business practices.[33]

These differing conceptualizations of financial firms and their stakeholders have long loomed large in U.S. law, which historically responded not only with prudential regulation, but also with conscious deviation from what is today regarded as the traditional corporate architecture.[34] Fiduciary duties have long been applied differently in U.S. banks. While the traditional formulation suggests that fiduciary duties of care and loyalty are owed "to the corporation and its stockholders"[35](a decidedly ambivalent and malleable formulation, to be sure),[36] by the early twentieth century, some courts were already expressly suggesting that

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30. *See* Patricia A. McCoy, *A Political Economy of the Business Judgment Rule in Banking: Implications for Corporate Law*, 47 CASE W. RES. L. REV. 1, 4, 72–73 (1996) (observing the differing characterization of bank depositors relative to typical corporate creditors).

31. *See* Bruner, *supra* note 26, at 312; Macey & O'Hara, *supra* note 26, at 326–30.

32. *See* Bruner, *supra* note 26, at 317 (discussing the empirical literature).

33. *See, e.g.*, Jonathan R. Macey & Geoffrey P. Miller, *Double Liability of Bank Shareholders: History and Implications*, 27 WAKE FOREST L. REV. 31, 31–39 (1992); Macey & O'Hara, *supra* note 26, at 326–33; McCoy, *supra* note 30, at 1–22; *see also* PATRICIA A. MCCOY, BANKING LAW MANUAL: FEDERAL REGULATION OF FINANCIAL HOLDING COMPANIES, BANKS AND THRIFTS § 14.01 (2d ed. 2012) (further observing that "the ratio of shareholders' equity to debt in the form of deposits is relatively low, allowing shareholders to leverage proportionately greater gains and to shift proportionately greater losses onto depositors and the deposit insurance funds").

34. In referring to "what is today regarded as the traditional corporate architecture," I have in mind the typical summary of core corporate attributes regularly recited in treatises and casebooks: limited liability for shareholders; free transferability of shares; legal personality; and centralized management through a board of directors owing a duty of loyalty to the corporation and the shareholders. *See, e.g.*, WILLIAM T. ALLEN, REINIER KRAAKMAN & GUHAN SUBRAMANIAN, COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATION 83–109 (2d ed. 2007); ROBERT CHARLES CLARK, CORPORATE LAW 1–34 (1986).

35. *See, e.g.*, N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla, 930 A.2d 92, 99 (Del. 2007); Guth v. Loft, 5 A.2d 503, 510 (Del. 1939).

36. *See* Bruner, *supra* note 1, at 1425–26; Lyman Johnson, *The Delaware Judiciary and the Meaning of Corporate Life and Corporate Law*, 68 TEX. L. REV. 865, 900, 923–24 (1990).

bank directors ought to show regard not only for the corporation as an entity, and its stockholders in particular, but also for its "depositors" and even "the general public."[37] The Court of Chancery of New Jersey suggested in 1901 that directors "are not only trustees for the corporation, but also, though, perhaps in a modified sense, for the creditors of the corporation, who become such by depositing their money with the bank."[38] Similarly, the New York Court of Appeals explained in 1909 that "[a] banking corporation occupies a different relation to the public, in that it invites individuals to submit to it the possession and care of their money and property."[39] Likewise, the Supreme Court of Arkansas stated in 1917 that bank boards "must exercise at least proper diligence to see that the officers and agents do their duty for the protection of creditors, stockholders, and the public generally."[40] A year later, the court further explained that bank directors "are liable to stockholders, as well as depositors, for its losses from their negligence in not knowing its condition and seeing that its affairs are honestly and properly managed."[41] The Supreme Court of Appeals of Virginia, in 1933, rejected the contention that, while the bank and the stockholders benefit from an "ordinary care" standard, depositors must establish "some malicious or fraudulent act, or at the least, . . . gross negligence" because they are "but creditors of the corporation and utter strangers to the obligations of the directors to it."[42] Rather, the court held "without hesitation" that the same care standard applied to bank directors "in the protection of their depositors."[43] In a similar spirit, the Supreme Judicial Court of Massachusetts stated in 1935 that bank directors "invite the confidence of the depositing public and must afford the protection thereby implied."[44]

Notwithstanding broader trends to the contrary in more recent times,[45] such formulations are not limited to the distant past. The U.S. Court of Appeals for the Tenth Circuit, for example, writing in 1993, stated that bank directors "owe a high degree of duty to the general public and stockholders."[46] Likewise, the U.S. District Court for the Southern District of New York stated in 2002 that the business judgment rule

37. *See* McCoy, *supra* note 30, at 38–39; *see also* 1C MICHIE ON BANKS AND BANKING, ch. 3, at 44, 52, 125–27, 201–17 (2010 ed.).

38. Campbell v. Watson, 50 A. 120, 124 (N.J. Ch. 1901).

39. Gause v. Commonwealth Trust Co. of New York, 89 N.E. 476, 482 (N.Y. 1909).

40. Bank of Commerce v. Goolsby, 196 S.W. 803, 808 (Ark. 1917).

41. Magale v. Fomby, 201 S.W. 278, 279 (Ark. 1918).

42. Anderson v. Bundy, 171 S.E. 501, 505–06 (Va. 1933).

43. *Id.* at 506.

44. Medford Trust Co. v. McKnight, 197 N.E. 649, 655 (Mass. 1935).

45. *See infra* Parts III–IV.

46. FDIC v. Appling, 992 F.2d 1109, 1113–14 (10th Cir. 1993) (quoting Hoehn v. Crews, 144 F.2d 665, 672 (10th Cir. 1944)).

"has not generally been found to apply to bank directors," explaining that "bank directors were traditionally held to a higher standard of diligence because of the quasi-public role of financial institutions in safekeeping the public's funds."[47] Similarly broad formulations of a bank director's obligations naturally remain popular among prudential regulators as well. A Federal Deposit Insurance Corporation (FDIC) policy statement indicates that "[d]irectors and officers of banks have obligations to discharge duties owed to their institution and to the shareholders and creditors of their institutions, and to comply with federal and state statutes, rules, and regulations."[48] The Basel Committee on Banking Supervision likewise states that "in addition to their responsibilities to shareholders, banks also have a responsibility to their depositors and to other recognised stakeholders" (while acknowledging that the "legal and regulatory system in a country determines the formal responsibilities a bank has" to various constituencies).[49]

At the same time, courts have applied a heightened standard of care to bank directors and have shown greater willingness to scrutinize managerial decision-making and impose personal liability for losses. In nonfinancial firms, directors virtually never face personal liability for care breaches due to the business judgment rule, which ordinarily precludes liability for unconflicted business decisions that can be ascribed to a rational business purpose.[50] In Delaware, this standard has been said to require a showing of "gross negligence" before liability could be imposed upon directors for a breach of the duty of care.[51] In banking, however, courts and legislatures have at times imposed a more exacting

47. FDIC v. Bober, No. 95 Civ. 9529 (JSM), 2002 U.S. Dist. LEXIS 13231, at *5–8 (S.D.N.Y. Aug. 8, 2002) (applying New York law).

48. *Statement Concerning the Responsibilities of Bank Directors and Officers*, FDIC, http://www.fdic.gov/regulations/laws/rules/5000-3300.html (last updated Dec. 3, 2009).

49. BASEL COMM. ON BANKING SUPERVISION, *supra* note 24, at 5–6. The Basel Committee "formulates broad [banking] supervisory standards and guidelines and recommends statements of best practice in the expectation that individual authorities will take steps to implement them through detailed arrangements . . . best suited to their own national systems." The Committee's member countries—including the United States—"are represented by their central bank and also by the authority with formal responsibility for the prudential supervision of banking business where this is not the central bank." *History of the Basel Committee and Its Membership*, BANK FOR INT'L SETTLEMENTS, http://www.bis.org/bcbs/history.htm (last visited Sept. 20, 2012).

50. *See supra* note 7 and accompanying text.

51. *See* Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984), *overruled on other grounds by* Brehm v. Eisner, 746 A.2d 244, 264 (Del. 2000). Today, the business judgment rule's insulation of director discretion is of course bolstered by statutory structures, notably exculpation statutes permitting corporations to eliminate monetary liability for care breaches through their charters. *See, e.g.*, DEL. CODE ANN. tit. 8, § 102(b)(7) (West 2009). For additional background on the duty of care, the business judgment rule, and statutory exculpation in Delaware, see Christopher M. Bruner, *Good Faith, State of Mind, and the Outer Boundaries of Director Liability in Corporate Law*, 41 WAKE FOREST L. REV. 1131, 1131–50 (2006).

standard of conduct on directors, largely for the protection of depositors.[52] As Patricia McCoy explains, "courts curtailed the business judgment rule in banking long before federal deposit insurance was adopted"—a doctrinal shift made "in reaction to profligate lending practices that wiped out depositors and triggered bank runs."[53] The result was "an unprecedented negligence cause of action in favor of depositors, who formed the most visible class of debtholders in banks."[54] As the Court of Chancery of New Jersey stated in 1901, a bank depositor has

> a right to rely upon the character of the directors and officers of the bank, and that they will perform their sworn duty to manage the affairs of the bank according to law and devote to its affairs the same diligent attention which ordinary, prudent, diligent men pay to their own affairs . . . .

The court added that this standard requires "such diligence and attention as experience has shown it is proper and necessary that bank directors should give to that business in order to reasonably protect the bank and its creditors against loss."[55] In 1933, the Supreme Court of Appeals of Virginia similarly refused to require depositors, unlike shareholders and the bank, to establish "gross negligence" in suits alleging board oversight

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52. *See* McCoy, *supra* note 30, at 38–43, 48–55; *see also* MCCOY, *supra* note 33, § 14.04[2]–[3], [6]; Macey & O'Hara, *supra* note 26, at 333–37. Following the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA), passed in response to the savings and loan crisis of the 1980s, federal law provides that directors and officers of an insured depository institution can be held monetarily liable for "gross negligence" in an FDIC action, permitting states to impose stricter, but not more lenient, standards of conduct. *See* MCCOY, *supra* note 33, § 14.04[2][a]–[b]; *see also* 1-6 KENNETH M. LAPINE ET AL., BANKING LAW § 6.04 (2012); JOHN K. VILLA, BANK DIRECTORS', OFFICERS', AND LAWYERS' CIVIL LIABILITIES § 1.02[A] (2012). In February 2012, the U.S. District Court for the Northern District of Georgia found that a failed bank's exculpatory charter provision did not apply to a suit filed by the FDIC as the bank's receiver. Georgia's business corporation statute permits exculpation of liability "to the corporation or its shareholders," but for Georgia banks, exculpation applies only to liability "to the shareholders of the bank." The court found that the FDIC, as receiver, acted as successor to the bank, not as a shareholder. *See* FDIC v. Skow, Civ. No. 1:11-CV-0111-SCJ, at *1–14 (N.D. Ga. Feb. 27, 2012); *see also* Joseph E. Finley et al., Jones Day, *FDIC Failed Bank Director and Officer Claims – Recent Court Decisions Better Define the Landscape*, MONDAQ (Mar. 22, 2012), *available at* http://www.mondaq.com/unitedstates/x/169776/Capital+Markets/FDIC+Failed+Bank+Director+and+Officer+Claims+Recent+Court+Decisions+Better+Define+The+Landscape.

53. McCoy, *supra* note 30, at 3.

54. *Id*. McCoy emphasizes "the watershed case of *Briggs v. Spaulding*," an 1891 U.S. Supreme Court decision that applied to national bank directors a tort-based duty of care requiring ordinary prudence. *Id.* at 35–43; *see also* VILLA, *supra* note 52, § 1.02[B]–[D]. While "the federal common law basis of *Briggs* did not survive *Erie Railroad Co. v. Tompkins*," and "state law, not federal common law, [now] provides the rule of decision in bank director liability cases," the *Briggs* approach "remains highly influential and has been incorporated into state law standards." For a federally chartered bank, the applicable corporate law is that of the state where the bank is headquartered. MCCOY, *supra* note 33, § 14.04[2][a]–[b].

55. Campbell v. Watson, 50 A. 120, 124 (N.J. Ch. 1901).

failures, concluding that "the protection of their depositors" required that directors be held to a standard of "ordinary care" in depositor suits as well.[56] Likewise, the Supreme Judicial Court of Massachusetts explained in 1935 that bank directors "are bound to exercise ordinary prudence and skill to care for and invest the money entrusted to the bank." The court continued,

> For errors of judgment while acting with integrity, 'skill and prudence, . . . they are not to be held liable; but they cannot excuse themselves from the consequences of their misconduct or of their ignorance or negligence by averring that they have failed merely to exercise ordinary skill, care and vigilance.'[57]

A more remarkable deviation from the traditional corporate architecture arose on the shareholder side of the governance equation in the form of multiple liability rules. This approach aimed to protect depositors by modifying the core structural attribute of corporate equity that otherwise led bank shareholders to crave risk, thus directly attacking the fundamental impetus for excessive risk-taking. Under multiple liability statutes—or in some cases, state constitutional provisions—if a bank failed, the shareholders lost not only the money initially invested when they purchased their stock, but also some additional multiple of that invested amount (assessed by the court at the behest of the failed bank's receiver). Most were so-called "double liability" statutes; for example, a shareholder who had initially paid $100 for the stock could be assessed an additional $100 for the benefit of creditors upon the bank's failure. This was the rule for national banks from the 1860s until the 1930s, by which point it was the rule for most state banks as well.[58] The strategy was elegantly straightforward: curb the shareholders' enthusiasm for risk by forcing them to absorb more losses. As Jonathan Macey and Geoffrey Miller put it, a double liability statute "transforms shareholders from investors seeking to advantage themselves at the expense of other investors by *increasing* the riskiness of the banks in which they have invested into investors who benefit themselves by *decreasing* the riskiness of these firms."[59]

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56. Anderson v. Bundy, 171 S.E. 501, 505–06 (Va. 1933).

57. Medford Trust Co. v. McKnight, 197 N.E. 649, 655 (Mass. 1935).

58. *See* Macey & Miller, *supra* note 33, at 35–39.

59. *Id.* at 33. For additional background on double liability statutes, see generally Howell E. Jackson, *Losses From National Bank Failures During the Great Depression: A Response to Professors Macey and Miller*, 28 WAKE FOREST L. REV. 919 (1993) (questioning Macey and Miller's data on losses following bank failures in the 1930s); Jonathan R. Macey & Geoffrey P. Miller, *Double Liability of Bank Shareholders: A Look at the New Data*, 28 WAKE FOREST L. REV. 933 (1993) (replying to Jackson); *see also* DAVID A. MOSS, WHEN ALL ELSE FAILS: GOVERNMENT AS THE ULTIMATE RISK MANAGER 93, 97–100, 115 (2002); Peter Conti-Brown, *Elective Shareholder Liabil-*

As remarkable as such incursions upon the sanctity of limited liability may seem today, this approach qualitatively resembles the principal constraint on risk-taking that prevailed in investment banks as late as the 1980s: the partnership organizational form. As general partners, investment bankers were exposed to unlimited personal liability for the firms' losses, creating a strong incentive to police very carefully the admission of new equity owners, as well as the nature and scope of financial risks undertaken in the firm's name.[60] As Claire Hill and Richard Painter explain, while investment banks "were not regulated for safety and soundness" like commercial banks were, "there may have been little need for such oversight" because liability rules effectively did the work. "A partner of Lehman Brothers did not want or need the government to tell him how to run his business; if the business failed, the partner paid." In the extreme, "[f]irms that did not exercise restraint failed in the next market downturn and they took their improvident partners with them."[61]

C. Populism and Corporate Governance

To this point I have emphasized how financial firms differ from non-financial firms—specifically, how the distinct nature and economic role of financial firms, and consequent differences in the conceptualization of various corporate stakeholders, have led to heightened concerns regarding excessive risk-taking and innovative efforts to protect depositors by imposing fiduciary constraints on boards and personal liability on shareholders. At a certain level of abstraction, however, there is a strong commonality with non-financial firms in terms of how issues of corporate purpose have arisen and how they have been addressed in U.S. corporate law.

The common thread unifying the dynamics described above, across financial and non-financial contexts alike, can be expressed in a single word: "populism." In using this term, I refer generally to social and polit-

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ity, 64 STAN. L. REV. 409, 458–59 (2012); Joseph M. Leonard, *Superadded Liability of Bank Stockholders*, 14 TEMP. L.Q. 522 (1940); Macey & O'Hara, *supra* note 26, 330–33. Australia, Canada, and the United Kingdom employed various multiple liability regimes as well. *See generally* Lewis T. Evans & Neil C. Quigley, *Shareholder Liability Regimes, Principal-Agent Relationships, and Banking Industry Performance*, 38 J.L. & ECON. 497 (1995); John D. Turner, *'The Last Acre and Sixpence': Views on Bank Liability Regimes in Nineteenth-Century Britain*, 16 FIN. HIST. REV. 111 (2009).

60. *See* Conti-Brown, *supra* note 59, at 459–60; Claire Hill & Richard Painter, *Berle's Vision Beyond Shareholder Interests: Why Investment Bankers Should Have (Some) Personal Liability*, 33 SEATTLE U. L. REV. 1173, 1175–78 (2010); Michael Lewis, *The End*, UPSTART (Nov. 11, 2008), http://upstart.bizjournals.com/news-markets/national-news/portfolio/2008/11/11/The-End-of-Wall-Streets-Boom.html; *see also* UNIF. PARTNERSHIP ACT § 15 (1914) (reflecting the personal liability of general partners).

61. Hill & Painter, *supra* note 60, at 1177.

ical appeals to the perceived interests of average working people—a force that has proven highly consequential in periods of corporate governance reform, and periods of broader financial regulatory reform, throughout American history.[62] To facilitate the discussion of post-crisis reform dynamics that follows, I explore, in the remainder of this section, how populist concerns for broader social welfare have historically affected corporate governance structures in non-financial and financial contexts, respectively.

1. Non-Financial Firms: Protecting "Employees"

In the non-financial context, hostile takeovers have most clearly reflected corporate law's ambivalence regarding shareholders because these transactions drive such an enormous wedge between the interests of shareholders and those of other stakeholders. In response, U.S. courts and legislators permitted deployment of powerful defenses like poison pills,[63] enabling target boards to prioritize firm sustainability over returns to shareholders. As discussed above, this move responded to the unique vulnerability of U.S. employees to the loss of job-linked social welfare benefits in a subsequent consolidation.[64]

In this episode, we see corporate law driven by powerful external political forces, which reflect the fundamental aim of insulating average working people from destabilizing social and economic shock—the "populist" impulse in American politics. For example, the preamble to a 1987 amendment to North Carolina's business combination statute observed that takeovers were "occurring with increasing frequency"; that such transactions could "be highly disruptive to communities . . . by causing, among other things, high unemployment and erosion of the state and local economy and tax base"; and that potentially vulnerable targets "provide their North Carolina employees with health, retirement and oth-

62. I have used the term populism similarly elsewhere, as have others. *See* Bruner, *supra* note 26, at 332–39; MARK J. ROE, STRONG MANAGERS, WEAK OWNERS: THE POLITICAL ROOTS OF AMERICAN CORPORATE FINANCE 29 (1994) (using the term "to refer to a widespread attitude that large institutions and accumulations of centralized economic power are inherently undesirable"); McCoy, *supra* note 30, at 4 n.7 (using the term to refer to "a way of thinking that identifies debtholders or depositors with individuals of modest means and champions their interests against the interests of larger corporate entities").

63. Poison pills, typically called "shareholder rights plans," effectively shut down hostile bids by threatening would-be bidders with substantial dilution should they exceed a specified ownership threshold (often ten to fifteen percent) without the target board's approval. Doing so would trigger "rights" attached to the shares, permitting all shareholders but the would-be bidder to buy deeply discounted stock. *See* ALLEN, KRAAKMAN & SUBRAMANIAN, *supra* note 34, at 536–39.

64. *See supra* notes 18–19 and accompanying text.

er benefits."[65] Such concerns for employee welfare were entirely justified given the degree to which state-based social welfare programs were scaled back in the United States during the 1980s and the correlative degree to which employees depended on their jobs for access to such benefits.[66] As Mark Roe concludes, "[p]opulist sentiment helped fuel the antitakeover legislation at the end of the 1980s."[67] Hostile takeovers, he explains, "disrupt the lives of managers and workers," and "[t]he public sympathized with workers displaced by manipulators from Wall Street." Indeed, according to a 1987 Harris poll, "58 percent of those polled thought hostile takeovers did more harm than good; only 8 percent thought hostile takeovers were beneficial." In this light, "laws restricting hostile takeovers were predictable."[68]

Delaware has addressed takeovers principally through case law,[69] though it would be a mistake to conclude on that basis that populist politics played no role. Antitakeover statutes generally raised the cost of takeovers without precluding them outright. As Roe explains, however,

> the key move probably was when states validated the poison pill, which *can* be a show-stopper. Since the key move validating the poison pill was judicial and judges are often seen as above politics, I do not think it is usually seen, as it should be, as part of takeover politics. . . . But because legislatures could reverse the judicial decisions, there is a public choice structure to the emergence and survival of the poison pill—the takeover show-stopper—as well.[70]

Delaware's takeover case law is, as Roe suggests, at least indirectly political insofar as the survival of controversial defenses like poison pills requires legislative acquiescence. However, Delaware's takeover decisions are intrinsically policy-laden in their own right and Delaware's judges are fully aware of it. Former Delaware Chancellor William Allen, then-Vice Chancellor (now Justice) Jack Jacobs, and then-Vice Chancellor (now Chancellor) Leo Strine, in a 2002 law review article, observed that Delaware's statute has "rarely been the method used to confront the major developments occurring in the mergers and acquisitions market-

65. *See* David Millon, *State Takeover Laws: A Rebirth of Corporation Law?*, 45 WASH. & LEE L. REV. 903, 922–23 (1988) (quoting 1987 N.C. Sess. Laws ch. 124).

66. *See* Bruner, *supra* note 10, at 639–40.

67. ROE, *supra* note 62, at 32.

68. *Id.* at 152–53. Roe further observes that antitakeover statutes often arose in response to a particular takeover bid—as in the case of North Carolina. *See id.* at 161.

69. Delaware's statute does in fact include a business combination provision. *See* DEL. CODE ANN. tit. 8, § 203 (West 2009). This provision includes several exceptions, however, and is thought to be "fairly mild as anti-takeover statutes go." *See* ALLEN, KRAAKMAN & SUBRAMANIAN, *supra* note 34, at 609 n.59.

70. ROE, *supra* note 62, at 160–61.

place during the last thirty years," creating a "legislative vacuum" requiring courts to create "legal rules [that] involve policy choices." They candidly concede that "[j]udges presented with takeover cases are unavoidably aware that the interests of more than stockholders are usually at stake," and recognize as "credibly arguable that an approach that locates these decisions in the hands of directors" may effectively balance shareholder and stakeholder interests.[71]

This perspective was fully in evidence in the Delaware Supreme Court's 1985 *Unocal* opinion, which stated that in determining how to respond to a hostile bid, the target board may legitimately consider "the nature of the takeover bid and its effect on the corporate enterprise," including "the impact on 'constituencies' other than shareholders (i.e., creditors, customers, employees, and perhaps even the community generally)."[72] It was equally apparent in the court's 1990 *Paramount v. Time* decision, which cited to *Unocal's* "constituencies" language in support of its conclusion that a target board with an articulable long-term strategy may maintain its defenses and simply refuse to negotiate with a hostile bidder, even in the face of an all-cash, all-shares, premium bid.[73]

The upshot is that, whether emerging from legislatures or courts, U.S. corporate law on takeovers reflects strong concerns for the welfare of non-shareholder constituencies, particularly employees—the conceptual category best encapsulating the perceived interests and vulnerabilities of average working people in non-financial firms. In the context where the interests of shareholders and other constituencies most sharply diverge, U.S. corporate law has empowered boards to prioritize firm sustainability over returns to shareholders, and populist regard for employees has proven to be an extremely powerful force in bringing about this outcome.

2. Financial Firms: Protecting "Depositors"

From a broad political perspective, similar dynamics have historically driven corporate governance in U.S. financial firms as well, though given the distinct nature and economic role of these firms, the fundamen-

71. William T. Allen, Jack B. Jacobs & Leo E. Strine, Jr., *The Great Takeover Debate: A Meditation on Bridging the Conceptual Divide*, 69 U. CHI. L. REV. 1067, 1068, 1074–89 (2002).

72. Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 955 (Del. 1985).

73. Paramount Commc'ns, Inc. v. Time Inc., 571 A.2d 1140, 1150–53 (Del. 1990). Roe attributes Delaware's takeover case law primarily to a perceived "threat of exodus" in the late 1980s "unless Delaware joined the antitakeover bandwagon." ROE, *supra* note 62, at 163–67. It bears emphasizing, however, that key opinions permitting regard for non-shareholders and use of poison pills came down in the mid-1980s. *See Unocal Corp*., 493 A.2d at 955 (including the "constituencies" language discussed above); Moran v. Household Int'l, Inc., 500 A.2d 1346, 1353–57 (Del. 1985) (legitimating preemptive use of poison pills).

tal aim of insulating average working people from destabilizing social and economic shock has manifested itself differently. While it is the "employee" conceptual category that best encapsulates the needs of average working people in the non-financial context, it is the "depositor" category that best encapsulates their needs in the financial context. Similarly, while foreclosing hostile takeovers most clearly reflects the firm sustainability norm in the non-financial context, foreclosing excessive risk-taking most clearly reflects this norm in the financial context.[74]

Strong populist appeals to the perceived interests of average working people largely drove the financial firm corporate governance innovations described above, as Patricia McCoy has recognized in her work on fiduciary duties in banking, and as Jonathan Macey and Geoffrey Miller similarly discerned in the advent of double liability rules.[75] As one decision by the New York Court of Appeals somewhat dramatically explained in 1880,

> [w]hat would be slight neglect in the care exercised in the affairs of a turnpike corporation, or even of a manufacturing corporation, might be gross neglect in the care exercised in the management of a savings bank intrusted with the savings of a multitude of poor people, depending for its life upon credit and liable to be wrecked by the breath of suspicion.[76]

Concerns for the welfare of average working people entrusting their savings to bank managers were similarly detectable in the Court of Chancery of New Jersey's 1901 decision discussed above, in which the court described "[b]anks of deposit and discount" as "*quasi* public institutions." The court further stated that "the man who makes a deposit in [a] bank" has "a right to rely upon the character of the directors and officers of the bank, and that they will perform their sworn duty" to exercise "such diligence and attention as experience has shown it is proper and necessary . . . to reasonably protect the bank and its creditors against loss."[77] Remarkably, the court emphatically rejected the notion that different rules might apply outside the context of a sophisticated financial center. To the contrary,

> [bank directors'] names give credit and standing to the institution, and are a guarantee to dealers that its affairs will be conducted with reasonable prudence and care and according to law. . . . I cannot

74. In drawing this distinction, it is worth adding that hostile takeovers have historically been rare in U.S. banking. *See, e.g.*, Adams & Mehran, *supra* note 23, at 126; Macey & O'Hara, *supra* note 26, at 338.

75. *See generally* McCoy, *supra* note 30; Macey & Miller, *supra* note 33.

76. Hun v. Cary, 82 N.Y. 65, 71 (1880).

77. Campbell v. Watson, 50 A. 120, 124 (N.J. Ch. 1901).

> yield to the suggestion of some of the defendants' counsel that the fact that the institution in question was a small country bank relieved its directors from adopting the same practical measures for protection against frauds and thefts as were in use by its greater neighbors in larger towns.[78]

The Supreme Judicial Court of Massachusetts, in the 1935 decision discussed above, similarly emphasized that the quality of bank management itself constituted a form of public inducement to trust the institution with one's money, stating that

> [bank directors] hold themselves out as having the superintendence and management of all the concerns of the bank. They thereby engage to conduct its business as men of reasonable ability, necessary intelligence and sound judgment ought to conduct it. . . . They invite the confidence of the depositing public and must afford the protection thereby implied.[79]

As McCoy explains, the heightened standard of care demanded of bank directors in such cases reflected "a populist concern for harm to individual depositors" that could result from bank failures.[80] "This populist image of depositors," she observes, "was driven by concerns about the devastating financial impact that lost savings would have on middle- and lower-income Americans," an image with extraordinary social and political resonance "due to the pervasiveness of bank depositors in practically every walk of American life. There is no other industry where ordinary citizens so ubiquitously serve as lenders."[81] While cases demonstrating such regard for bank depositors were initially limited to certain jurisdictions—notably Arkansas, Massachusetts, New Jersey, New York, and Virginia—by the early 1930s "a majority of bank director negligence cases subordinated potential profit maximization in favor of loss avoidance." This involved "judicial assessments of risk and the ensuing judgment that risk levels were too high to merit protection under the business judgment rule"—meaning greater reliance on the duty of care to protect depositors and ensure stability in American banking.[82]

Similar populist impulses motivated double liability rules as well, which aimed quite directly to protect depositors from excessive risk-

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78. *Id.* at 125; *see also* Anderson v. Bundy, 171 S.E. 501, 506–08 (Va. 1933) (citing *Hun v. Cary* and *Campbell v. Watson* in support of a robust standard of care to protect depositors).

79. Medford Trust Co. v. McKnight, 197 N.E. 649, 655 (Mass. 1935).

80. *See* McCoy, *supra* note 30, at 38–40.

81. *Id.* at 73.

82. *Id.* at 38–43. With the advent of federal deposit insurance in 1933, concern for the welfare of average working depositors merged with a more direct federal governmental interest in minimizing losses from bank failures. *See id.* at 40.

taking. At the 1846 constitutional convention adopting New York's influential double liability provision, its proponent, Churchill Cambreleng, reportedly argued that "deposites in a bank were a trust fund as sacred as any other obligation," that "[w]ithout some responsibility in addition to what we now had, we should have an unsafe system of banking," and that "we were bound to protect the community against their insolvency." In proposing double liability for bank shareholders, "[h]is object was to place the banks on a perfectly sound footing; and every sound banker should wish to see it so." Indeed, Cambreleng "said he offered this section as a compromise," and that he in fact "should have preferred unlimited responsibility himself."[83]

When a similar provision was applied to national banks by statute in the 1860s, its Senate proponent, John Sherman of Ohio, cited the New York model and argued that bank depositors "should have something more than the stock to fall back upon; and that if you provide a limited liability to an amount equal to the stock, in addition to the stock, you will make it ample beyond all danger"—an approach that he noted had already "been embodied in the laws of a great majority of the States."[84] A year later, when clarifying amendments to the statute were made, Sherman added, "I think that individual liability tends to prevent the stockholders and directors of a bank from engaging in hazardous operations. I never would be willing to surrender the general principle of individual liability." Responding to the argument that shareholders could simply be left to "appoint good directors and managers of their institutions, or let them lose their money," Sherman replied, "[i]t is the depositors and creditors we want to secure."[85] Based on their historical review of the enforcement of double liability rules in the late nineteenth and early twentieth centuries, Macey and Miller conclude that these rules "fostered cautious banking practices on the part of bank managers who were either themselves shareholders and always were subject to monitoring by shareholders anxious to avoid the specter of assessment."[86]

83. REPORT OF THE DEBATES AND PROCEEDINGS OF THE CONVENTION FOR THE REVISION OF THE CONSTITUTION OF THE STATE OF NEW YORK, 1846, REPORTED BY WILLIAM G. BISHOP AND WILLIAM H. ATTREE 997–98 (1846) (paraphrasing comments of Churchill C. Cambreleng).

84. CONG. GLOBE, 37th Cong., 3d Sess. 824 (1863) (reporting comments of Ohio Senator John Sherman).

85. CONG. GLOBE, 38th Cong., 1st Sess. 1869–70 (1864) (reporting Senator Sherman's response to arguments of Massachusetts Senator Henry Wilson).

86. Macey & Miller, *supra* note 33, at 58. For additional discussion of their efficacy, see Jackson, *supra* note 59, at 921 (arguing that "the losses imposed on depositors in national banks that failed during the 1930–34 period were much higher than those reported by Macey and Miller" in their 1992 article); Macey & Miller, *supra* note 59, at 937 (responding that "the conclusion that *depositors would have been worse off without double liability* seems impossible to refute").

Each of these deviations from the traditional corporate architecture—imposing heightened fiduciary duties on directors and personal liability on shareholders—were consciously aimed at protecting "depositors," a stakeholder group thought to represent the interests of average working people. This reflects the same populist impulse that has led to the protection of "employees" in non-financial contexts under U.S. corporate law. Although the manifestation of this social and political force has taken a different form in the financial context, this simply reflects the differing economic role and nature of financial firms and resulting differences in how we conceptualize the relevant corporate stakeholders in these firms. These differences, as we have seen, led corporate law to favor divergent corporate governance structures in financial and non-financial contexts but toward the same fundamental goal—social and economic stability for average working people.

III. Shareholder Centrism and Populist Politics in the Wake of the Crisis

Fast-forward to the present day, in which we look back upon a catastrophic financial and economic crisis widely ascribed to reckless financial firm managers. In light of the foregoing historical account emphasizing corporate governance innovations aimed at curtailing risk-taking in banks, the questions we face appear all the more vexing. What exactly went wrong? More specifically, what was the role of corporate governance in the run-up to the current crisis? And how have populist social and political dynamics expressed themselves in post-crisis reform efforts?

Many have observed that, over the last several decades, the inherent challenges of financial firm management have grown substantially as financial firms and financial products alike have become larger, more complex, and increasingly opaque—the result being the tangled web of mortgage-backed securities, and derivatives thereon, that rendered the balance sheets of U.S. (and U.K.) financial firms effectively unintelligible.[87] Far fewer have acknowledged, however, that corporate architectural strategies that historically constrained financial risk-taking were effectively marginalized, or discarded entirely, in parallel with those developments.[88]

As I discuss in this part of the Article, the trend over recent decades toward full-service financial firms with publicly traded stock has placed far greater emphasis on generating returns for financial firm shareholders

87. *See* Bruner, *supra* note 26, at 311–16 and sources cited therein.
88. Exceptions include those discussed below. *See infra* Part IV.

while simultaneously blurring corporate law's historical distinction between financial and non-financial firms. The predictable results have been stronger incentives to engage in financial risk-taking and a weaker capacity to limit it through corporate law.

A. Shareholder Centrism, Risk-Taking, and Financial Firms

Multiple liability for shareholders of national banks was abandoned in the mid-1930s following the advent of deposit insurance, and the states phased it out through the mid-1950s,[89] effectively removing two brakes that had previously curbed shareholders' enthusiasm for risk—multiple liability on the one hand and creditor incentives to monitor on the other. To be sure, prudential regulation stepped in as a substitute, but we might reasonably query the adequacy of this approach, not least given the informational disadvantage under which external government regulators inevitably labor—which, of course, would only become more problematic as time passed. Beginning in the 1970s, commercial banks would become larger, more complex, more competitive, and more stock price-driven as regulations constraining their size, markets, and activities were systematically dismantled.[90] At the same time, investment banking firms similarly broke from their historical moorings in partnership in the 1970s and 1980s to become publicly traded corporations. This move strongly reinforced the shareholder-centric ethos in contemporary finance and further encouraged a culture of risk-taking.[91] These trends merged in the 1999 Gramm-Leach-Bliley Act, permitting the rise of the full-service financial holding company engaged in both investment and commercial banking that now defines modern American finance.[92]

One might have expected fiduciary duties to loom all that much larger in the modern financial landscape given the enormous economic reach and significance of these firms and the systemic risks they can im-

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89. *See* John R. Vincens, *On the Demise of Double Liability of Bank Shareholders*, 75 BANKING L.J. 213, 214–16 (1958); *see also* Leonard, *supra* note 59, at 524–25.

90. *See* Bruner, *supra* note 26, at 311–13.

91. *See supra* notes 60–61 and accompanying text; *see also* Malcolm S. Salter, *How Short-Termism Invites Corruption . . . . And What to Do About It* 10–12, 17–18 (Harvard Bus. Sch. Working Paper No. 12-094, 2012), http://hbswk.hbs.edu/item/7015.html; Matt Schifrin, *Jamie Dimon's Folly: Shareholders Over Customers*, FORBES (May 16, 2012), http://www.forbes.com/sites/schifrin/2012/05/16/jamie-dimons-folly-shareholders-over-customers/.

92. *See* Bruner, *supra* note 26, at 313. The Gramm-Leach-Bliley Act amended the Bank Holding Company Act to permit a bank holding company "to declare itself a financial holding company . . . and thereby engage in financial activities, including securities underwriting and dealing, insurance agency and underwriting activities, and merchant banking activities." The Federal Reserve suggests that "it is useful to think of an FHC as a hybrid form of BHC that has additional authority to make financial investments." *See Bank Holding Companies and Financial Holding Companies*, PARTNERSHIP FOR PROGRESS, http://www.fedpartnership.gov/bank-life-cycle/grow-shareholder-value/bank-holding-companies.cfm (last visited Jan. 6, 2013).

pose upon society at large. Yet, the fact that heightened common law duties of care and loyalty continue to apply in banks themselves[93] does not mean these heightened duties will apply in financial holding companies—the corporate level where broader risk-management challenges and associated public welfare concerns now loom largest. As of December 2011, JPMorgan Chase, the largest U.S. financial holding company, had consolidated assets of $2.266 trillion.[94] To put that number in crude perspective, it exceeds the gross domestic product (GDP) of all but five countries on Earth; it is roughly equivalent to U.K. GDP, and it amounts to about fifteen percent of U.S. GDP.[95] The top five financial holding companies—JPMorgan Chase, Bank of America, Citigroup, Wells Fargo, and Goldman Sachs—total $8.514 trillion,[96] or about fifty-six percent of U.S. GDP.[97] These institutions are enormous, and it is exceedingly difficult to monitor their far-flung and diverse financial businesses effectively. When things go wrong, then, and managers find themselves facing Delaware shareholder suits,[98] Delaware's judges cut them considerable slack. Applying not some finance-specific conception of the requisite care, but rather the monitoring standard now applied to all publicly traded Delaware corporations, directors are deemed to have discharged their

93. *See* MCCOY, *supra* note 33, § 14.04. The Federal Reserve reports that "about 84 percent of commercial banks in the U.S. are part of a BHC structure. More than 75 percent of small banks with assets of less than $100 million are owned by BHCs; this percentage increases to 100 percent for large banks with more than $10 billion in assets." *Bank Holding Companies and Financial Holding Companies*, *supra* note 92.

94. *See Top 50 HCs*, FED. FIN. INSTITUTIONS EXAMINATION COUNCIL, http://www.ffiec.gov/nicpubweb/nicweb/Top50Form.aspx (last updated Sept. 30, 2012).

95. *See National Income and Product Accounts: Gross Domestic Product, 4th Quarter 2011 and Annual 2011 (third estimate); Corporate Profits, 4th Quarter 2011 and Annual 2011*, BUREAU ECON. ANALYSIS (Mar. 29, 2012), [hereinafter *National Income and Product Accounts*] http://www.bea.gov/newsreleases/national/gdp/2012/gdp4q11_3rd.htm (reporting U.S. GDP of $15.319 trillion for the fourth quarter); *Gross Domestic Product 2010*, WORLD BANK (July 1, 2011), http://siteresources.worldbank.org/DATASTATISTICS/Resources/GDP.pdf (indicating that only the United States, China, Japan, Germany, and France were higher, while U.K. GDP was $2.246 trillion).

96. *See Top 50 HCs*, *supra* note 94.

97. *See National Income and Product Accounts*, *supra* note 95.

98. The top five U.S. financial holding companies are all Delaware corporations with common stock trading on the New York Stock Exchange (NYSE). *See* JPMorgan Chase & Co., Annual Report (Form 10-K) (Feb. 29, 2012), *available at* http://www.sec.gov/Archives/edgar/data/19617/000001961712000163/corp10k2011.htm (NYSE: JPM); Bank of America Corp., Annual Report (Form 10-K) (Feb. 23, 2012), *available at* http://www.sec.gov/Archives/edgar/data/70858/000007085812000155/bac-12312011x10k.htm (NYSE: BAC); Citigroup Inc., Annual Report (Form 10-K) (Feb. 24, 2012), *available at* http://www.sec.gov/Archives/edgar/data/831001/000120677412000799/citigroup_10k.htm (NYSE: C); Wells Fargo & Co., Annual Report (Form 10-K) (Feb. 28, 2012), *available at* http://www.sec.gov/Archives/edgar/data/72971/000119312512084528/d280360d10k.htm (NYSE: WFC); The Goldman Sachs Grp., Inc., Annual Report (Form 10-K) (Feb. 28, 2012), *available at* http://www.sec.gov/Archives/edgar/data/886982/000119312512085822/d276319d10k.htm (NYSE: GS).

duty to monitor in good faith so long as some type of monitoring system was in place. As the Court of Chancery explained in its well-known *Caremark* decision, "only a sustained or systematic failure of the board to exercise oversight—such as an utter failure to attempt to assure a reasonable information and reporting system exists—will establish the lack of good faith that is a necessary condition to liability."[99] This is an exceptionally difficult standard for plaintiffs to meet, as shareholders of Citigroup and Goldman Sachs learned to their chagrin when they sought damages in Delaware for their managers' alleged failures to heed "red flags" in the housing and mortgage-backed securities markets.[100] It would appear that even JPMorgan Chase's much-heralded risk-management systems have proven insufficient to keep a lid on the global trading operations of such a mammoth institution, as the breach of the "London Whale" and resulting multi-billion-dollar trading losses have so vividly demonstrated.[101] Short of a finding of outright fraud, however, Delaware's corporate fiduciary duties will have little if any role to play in the matter.[102]

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99. *See In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 971 (Del. Ch. 1996); *see also* Stone v. Ritter, 911 A.2d 362, 369 (Del. 2006) (endorsing the *Caremark* standard for oversight cases). While styling oversight as a matter of the "good faith" component of loyalty, as opposed to care, benefits plaintiffs by permitting such claims to overcome exculpatory charter provisions, the *Caremark* standard is rightly said to be exceedingly difficult for plaintiffs to meet. *See* Bainbridge, *supra* note 27, at 975–76; *see also* Christopher M. Bruner, *Good Faith in Revlon-Land*, 55 N.Y.L. SCH. L. REV. 581, 584–91 (2010–2011); Bruner, *supra* note 51, at 1157–59. On the difficulty of enforcing the duty to monitor in the United Kingdom, see Simon Deakin, *What Directors Do (and Fail to Do): Some Comparative Notes on Board Structure and Corporate Governance*, 55 N.Y.L. SCH. L. REV. 525 (2010–2011).

100. *See generally In re* Citigroup Inc. Shareholder Derivative Litig., 964 A.2d 106 (Del. Ch. 2009); *In re* The Goldman Sachs Grp., Inc. Shareholder Litig., Civ. No. 5215-VCG, 2011 Del. Ch. LEXIS 151 (Del. Ch. Oct. 12, 2011); *see also* Bainbridge, *supra* note 27; Johnson, *supra* note 27, at 78–92; Renee M. Jones & Michelle Welsh, *Toward a Public Enforcement Model for Directors' Duty of Oversight*, 45 VAND. J. TRANSNAT'L L. 343, 356–63 (2012); Salter, *supra* note 91, at 3–6.

101. Bruno Iksil, a London-based trader in JPMorgan Chase's Chief Investment Office (CIO), reportedly "amassed positions in securities linked to the financial health of corporations that were so large he was driving price moves in the $10 trillion market." The fallout from multi-billion-dollar losses on his trades has "shattered JPMorgan's cultivated reputation for policing risk and undermined [CEO Jamie] Dimon's authority as a critic of regulatory efforts to curb speculation by too-big-to-fail banks." *See* Dawn Kopecki & Max Abelson, *Dimon Fortress Breached as Push From Hedging to Betting Blows Up*, BLOOMBERG (May 14, 2012), http://www.bloomberg.com/news/2012-05-14/dimon-fortress-breached-as-push-from-hedging-to-betting-blows-up.html; *see also* Peter Coy, *The Hubris of Jamie Dimon*, BLOOMBERG BUSINESSWEEK (May 17, 2012), http://www.businessweek.com/articles/2012-05-16/the-hubris-of-jamie-dimon; Tim Mak, *Elizabeth Warren: Dimon Should Quit N.Y. Fed*, POLITICO (May 15, 2012), http://www.politico.com/news/stories/0512/76265.html; Scott Patterson, *Dimon: J.P. Morgan Loss 'Terrible, Egregious Mistake,'* WALL ST. J. (May 13, 2012), http://online.wsj.com/article/SB100014240527023041927045774021021 96099694.html.

102. *See* Bob Van Voris, *JPMorgan Shareholders Sue Dimon Over $2 Billion Loss*, BLOOMBERG BUSINESSWEEK (May 16, 2012), http://www.bloomberg.com/news/2012-05-

While as recently as 2009 the empirical literature on financial firm corporate governance remained surprisingly thin, the nascent post-crisis literature does tend to suggest that risk-taking to boost financial firm stock prices must figure centrally in any coherent narrative of the crisis. We already knew from studies of non-financial firms that strong shareholder orientation is associated with greater risk-taking[103] and that bond premiums rise as management equity ownership rises (suggesting greater perceived risk among bondholders).[104] Conversely, "CEOs who are insulated from shareholder pressure and do not receive high-powered pay are less prone to engage in risk-taking."[105] Thus, it is hardly surprising that a growing body of post-crisis empirical studies tends to associate equity-based pay and greater shareholder orientation with greater risk-taking in financial firms in the run-up to the crisis.[106] For example, Renee Adams found that banks receiving bailout funds under the TARP program "have more independent boards, larger boards, more outside directorships and greater incentive pay for CEOs."[107] Rüdiger Fahlenbrach and René Stulz similarly found that "banks led by CEOs whose interests were better aligned with those of their shareholders had worse stock returns and a worse return on equity" during the crisis—evidence perhaps suggesting

16/jpmorgan-shareholders-sue-dimon-over-2-billion-trading-loss.html (reporting the filing of securities fraud and derivative suits); *see also* Stephen Bainbridge, *JP Morgan's Caremark Exposure*, PROFESSORBAINBRIDGE.COM (May 13, 2012), http://www.professorbainbridge.com/professorbainbridgecom/2012/05/jp-morgans-caremark-exposure.html (arguing, in light of the *Caremark* and *Citigroup* decisions, "that—assuming the existence of an adequate monitoring system—liability only arises where there is 'a sustained or systematic failure' on the board's part to respond to red flags that are numerous, serious, directly in front of the directors, and indicative of a corporate-wide problem," effectively meaning a failure to monitor "so inexplicable that no other explanation [than] bad faith or disloyalty makes sense").

In July 2012, JPMorgan disclosed that its losses on the trades had grown to $5.8 billion following an internal investigation suggesting that "traders recorded the value of their trades at current market prices, rather than prices they would get if they liquidated their large positions, in an effort to avoid reporting their full paper losses." Probes were initiated in the United Kingdom by the Financial Services Authority, and in the United States by the FBI, the SEC, the CFTC, the FDIC, the Comptroller of the Currency, and the Federal Reserve Bank of New York. Reuters reported that "regulatory and legal consequences will linger for some time. Blame for the problems at the CIO office may go further up the management chain to some of the most senior executives at the firm, lawyers said." David Henry & Aruna Viswanatha, *U.S. Investigates Whether JPMorgan Traders Hid Losses*, REUTERS (July 13, 2012), http://www.reuters.com/article/2012/07/13/us-jpmorgan-earnings-idUSBRE86C0G420120713.

103. *See* Kose John et al., *Corporate Governance and Risk-Taking*, 63 J. FIN. 1679, 1708 (2008). For a discussion of the lack of empirical support for the claim that shareholder centrism improves corporate performance more generally, see STOUT, *supra* note 16, at 47–60.

104. *See* Frederick Tung, *Pay for Banker Performance: Structuring Executive Compensation for Risk Regulation*, 105 NW U. L. REV. 1205, 1217 n.60 (2011).

105. Lucian A. Bebchuk & Holger Spamann, *Regulating Bankers' Pay*, 98 GEO. L.J. 247, 262 (2010).

106. *See* Deakin, *supra* note 17, at 341–43, 379.

107. Adams, *supra* note 23, at 13.

that "CEOs focused on the interests of their shareholders in the build-up to the crisis and took actions that they believed the market would welcome."[108] Conversely, Frederick Tung and Xue Wang found that "bank CEOs' inside debt holdings preceding the Crisis are significantly positively associated with better stock returns and accounting return on assets," and significantly negatively associated with risk-taking.[109]

In light of the foregoing, one might have expected corporate governance reforms aimed at insulating financial firm management from equity market pressures and associated risk incentives. Indeed, even some of the most committed academic proponents of shareholder-centric corporate governance have acknowledged that, whatever the merits of their arguments in the non-financial context may be, it is a recipe for excessive risk in the unique context of financial firms.[110] Yet, post-crisis reforms in the United States (as in the United Kingdom) have aimed to empower shareholders further in financial and non-financial contexts alike.

B. Post-Crisis Populism

How do we explain these apparently anomalous developments? As we have seen, populism has played a critical role in the evolution of U.S. corporate governance in both financial and non-financial firms. While this has typically militated in favor of "employees" in non-financial firms and "depositors" in financial firms, in some instances populist politics have cut differently. Consider, for example, the shift in risk-management strategy from double shareholder liability to deposit insurance starting in the 1930s. To be sure, this was substantially prompted by the view that only a rock-solid U.S. government guarantee could halt a banking crisis of that magnitude.[111] This shift in approach was reinforced, however, by populist regard for small shareholders, many of whom were thought to

108. Rüdiger Fahlenbrach & René Stulz, *Bank CEO Incentives and the Credit Crisis* 1 (Nat'l Bureau of Econ. Research, Working Paper No. 15212, 2009); *see also* Laeven & Levine, *supra* note 23, at 273 (finding that "banks with more powerful owners tend to take greater risks"); Andrea Beltratti & René M. Stulz, *Why Did Some Banks Perform Better During the Credit Crisis?: A Cross-Country Study of the Impact of Governance and Regulation* 3 (Nat'l Bureau of Econ. Research, Working Paper No. 15180, 2009) (finding that "banks with more pro-shareholder boards performed worse during the crisis").

109. Frederick Tung & Xue Wang, *Bank CEOs*, *Inside Debt Compensation, and the Global Financial Crisis* 4 (Boston Univ. Sch. of Law, Working Paper No. 11-49, 2011).

110. *Compare, e.g.*, Lucian A. Bebchuk, *The Myth of the Shareholder Franchise*, 93 VA. L. REV. 675 (2007) (advocating stronger shareholder powers in the non-financial context), *with* Bebchuk & Spamann, *supra* note 105 (arguing that, in order to reduce risk-taking, compensation in banks should not focus narrowly on aligning managers' interests with those of common shareholders).

111. *See* Macey & Miller, *supra* note 33, at 38–39; *see also* Leonard, *supra* note 59, at 524–25; Vincens, *supra* note 89, at 214.

have bought bank stock during the 1920s, unmindful of the obligations they were taking on, only to find themselves facing financial ruin with the onset of the Great Depression. As a 1958 article in the *Banking Law Journal* assessing "the demise of double liability" expressed it,

> [e]ven where assessments could be collected, they often fell as a calamity upon the businessmen of an already stricken community. Not infrequently they were imposed after a shareholder had departed this world, and the burden of payment was thus thrust upon his widow and children.[112]

Thus, in some circumstances, populist regard for the interests of average working people can cut in favor of corporate shareholders as well.

That, in essence, is what we observe in the wake of this most recent crisis, though for reasons that ought to trouble us. U.S. reform initiatives in the wake of the crisis have been replete with expressions of sympathy for the American "middle class"—an amorphous concept effectively standing for the investment-related and social welfare-related interests of the average working family, including the security of savings for education and retirement as well as the stability of employer-based healthcare arrangements. Among other things, this has taken the form of targeted political initiatives like Senator Charles Schumer's proposed "Shareholder Bill of Rights Act," which, if enacted, would have included a raft of shareholder-friendly reforms, including clear authority for the Securities and Exchange Commission (SEC) to establish a proxy access regime; "say on pay" (and golden parachute) votes; and exchange listing rules requiring independent board chairs, as well as annual board elections with majority, rather than plurality, voting.[113] By way of justification for such reforms, Senator Schumer's bill claimed that "among the central causes of the financial and economic crises . . . has been a widespread failure of corporate governance," and that "a key contributing factor . . . was the lack of accountability of boards to their ultimate owners, the shareholders." The stakes for the middle class, then, are emphasized in the further claim that "such failure has led to the loss of trillions of dollars in shareholder value, losses that have been borne by millions of Americans who are shareholders" not only through "direct investments," but also "through their pension plans [and] 401(k) plans."[114] The clear aim is to direct the ire of middle-class voters—whether seeing them-

112. Vincens, *supra* note 89, at 214; *see also* Macey & Miller, *supra* note 33, at 37.

113. Shareholder Bill of Rights Act of 2009, S. 1074, 111th Cong. §§ 3–5. Some of these proposals were ultimately included in the Dodd-Frank Wall Street Reform and Consumer Protection Act. *See infra* notes 128–29 and accompanying text.

114. S. 1074 § 2.

selves primarily as "shareholders" or "employees"—against purportedly reckless and unaccountable management.

In a similar spirit, President Obama's "Middle Class Task Force" (led by Vice President Biden) was created to promote a broad range of initiatives including not only financial reforms culminating in the Dodd-Frank Act, but also health insurance reforms aimed at expanding coverage to tens of millions of previously uninsured Americans.[115] In 2009, the Middle Class Task Force described the broader regulatory "challenge we face" as being "to reconnect the living standards of middle-class families to the economic growth they themselves are creating"[116]—a framing of the task that would ultimately allow reformers to link the security of middle-class working families not only with stronger social welfare protections, but also with shareholder-centric governance reforms (and, implicitly, the marginalization of parasitic management). In each instance, the overarching theme of "middle class" security has effectively functioned to merge traditional "shareholder" and "employee" interests in a powerful anti-manager political coalition, dovetailing nicely with the management-recklessness narrative that has dominated press accounts of the crisis.[117]

It is entirely comprehensible that post-crisis reforms would aim to alleviate widespread social welfare concerns. What is troubling is the notion that shareholder empowerment is somehow intrinsically bound up with the interests of the American middle class—a claim resting on flawed premises. Aside from the fact that recent research on the demographics of American shareholding tends to contradict any direct association with middle-class interests,[118] the claimed conceptual link is difficult to establish even in the context where "shareholder" and "em-

115. *See Middle Class Task Force*, THE WHITE HOUSE, http://www.whitehouse.gov/strongmiddleclass (last visited Sept. 20, 2012).

116. MIDDLE CLASS TASK FORCE, THE AMERICAN RECOVERY AND REINVESTMENT ACT: HELPING MIDDLE-CLASS FAMILIES 5 (2009), *available at* http://www.whitehouse.gov/assets/documents/staff_report_ARRA-FINAL.pdf.

117. *See* Bruner, *supra* note 26, at 316, 336–39. Mark Roe presciently anticipated the potential for such a development, observing in 1994 that "[a]nti-finance 'populism' is not what it once was as a political force." He elaborates that "if the political contest is seen as pitting responsible institutions against greedy managers, we could imagine the resulting rules as not hurting shareholder activism badly. The attention to managerial salaries in the media suggests that modern 1990s' 'populism' can target managers as well as institutions." ROE, *supra* note 62, at 285.

118. Based on Federal Reserve and IRS data, William Bratton and Michael Wachter "show that even as shareholding has diffused downward to lower income individuals the shareholders' overall socio-economic status has remained largely unchanged." Bratton and Wachter conclude that "there is nothing inherently democratic or progressive about the shareholder interest in corporate politics." *See* William W. Bratton & Michael L. Wachter, *Shareholders and Social Welfare*, 36 SEATTLE U. L. REV. 489, 491 (2013). On the heterogeneity of shareholder preferences, see STOUT, *supra* note 16, at 9–10, 63–94.

ployee" interests seem most directly to merge—pension fund investments. For example, SEC Commissioner Luis Aguilar, in a June 2012 speech to the National Association of Public Pension Attorneys, spoke of "how public pension funds, *in their capacity as shareowners and investors*, can be a more effective voice for America's working families." Specifically, Aguilar suggests that, "*[a]s fiduciaries*, public pension plans can be a powerful voice on behalf of their beneficiaries, working men and women whose voices are often drowned out."[119] He does not, however, spell out precisely how he envisions this working in practice. If the idea is that public pension funds advance the interests of working families through pursuit of political agendas unrelated to generating returns, as some believe they are wont to do, then this would presumably conflict with the state law duties their trustees owe to the funds' beneficiaries.[120] If, on the other hand, as Aguilar claims, the idea is that public pension funds foster stability because they "typically invest with a long-term perspective" representing "patient capital" counteracting "a capital markets environment that is often all too focused on quarterly returns,"[121] then the rationale stands in tension with the clear trend in recent years.

While Aguilar acknowledges that pension fund returns have fallen over the last decade, and that "the gap between asset values and projected liabilities has widened, leading to long-term concerns about sustainability,"[122] he does not mention that this has already led public pension funds to focus increasingly on short-term returns in exactly the manner that he (rightly) decries.[123] While the effort to ensure that current obligations are met may help maintain working families' near-term confidence, it hardly contributes to the long-term stability of the retirement systems

119. Luis A. Aguilar, Comm'r, Sec. & Exch. Comm'n, Pension Funds as Owners and Investors: A Voice for Working Families, Keynote Address to the National Association of Public Pension Attorneys 2012 Legal Education Conference (June 27, 2012), *available at* , http://www.sec.gov/news/speech/2012/spch062712laa.htm (emphasis added).

120. *See, e.g.*, Iman Anabtawi, *Some Skepticism About Increasing Shareholder Power*, 53 UCLA L. REV. 561, 588–89 (2006).

121. *See* Aguilar, *supra* note 119.

122. *Id.*

123. *See* David Millon, *Shareholder Social Responsibility*, 36 SEATTLE U. L. REV. 911 (2013). Institutional investors' growing emphasis on short-term returns also reflects more active trading and correlatively shorter holding periods. *See* Salter, *supra* note 91, at 12–13 (observing "the rapidly declining costs of trade in equities and the corresponding rise of 'hyperspeed' traders" who now represent "as much as 70 percent of all trade in U.S. equities," and who "have zero interest in an investment's long-term value"); *see also* STOUT, *supra* note 16, at 66–67 ("[I]n 1960, annual share turnover for firms listed on the [NYSE] was only 12 percent. . . . By 1987, this figure had risen to 73 percent. By 2010, the average annual turnover for equities listed on U.S. exchanges reached an astonishing 300 percent annually, implying an average holding period of only four months."). As Malcolm Salter emphasizes, these trends are exacerbated by the practice of issuing "earnings guidance," which further focuses the minds of analysts and management alike on quarterly stock price performance. *See* Salter, *supra* note 91, at 13–15, 22.

on which they will ultimately depend or the long-term stability of corporate employers and the financial system. Indeed, if Aguilar's idea is that public pension funds are well positioned to reduce risk-taking of the sort that led to the crisis—as he implicitly suggests in citing reforms in the Dodd-Frank Act "intended to help empower shareholders to exercise their rights . . . and to make sure that a company's directors and officers are living up to their responsibility to act as prudent stewards of the assets entrusted to them"[124]—then this plainly conflicts with the empirical literature discussed above (particularly in light of public pension funds' increasingly short-term investment horizons).[125] Asserting that shareholders speak "for America's working families" may make for powerful rhetoric, but the claim fails to withstand even moderate scrutiny.[126]

There is simply no reason to believe that stronger shareholders would have mitigated risk-taking in the run-up to the crisis or could be expected to do so moving forward, and the resulting contradictions of the post-crisis shareholder empowerment agenda are readily apparent in reform efforts on both sides of the Atlantic. In the United Kingdom, for example, the Walker Report's analysis of financial firm corporate governance rightly acknowledges that shareholders may have supported greater leverage for "the very high returns that could be generated," and that short-term equity market pressures "in many cases led to both encouragement and greater acceptance of increased leverage." Yet, Walker suggests that shareholders could be expected to act as responsible "stewards," pressuring bank managers to focus on the long-term. This is an odd suggestion given Walker's expression of hope that greater exposure to management might be the mechanism by which to "moderate shareholder focus on short-term performance."[127]

124. *See* Aguilar, *supra* note 119.

125. *See supra* notes 103–09 and accompanying text.

126. Aguilar further suggests that "when [pension fund] beneficiaries spend their paychecks, they support local business owners and other segments of the economy, providing, in effect, a stimulus to business revenues and helping to generate economic demand and employment." Aguilar, *supra* note 119. In itself, however, this has no direct bearing on the issue of how much governance power shareholders ought to possess.

127. DAVID WALKER, A REVIEW OF CORPORATE GOVERNANCE IN U.K. BANKS AND OTHER FINANCIAL INDUSTRY ENTITIES: FINAL RECOMMENDATIONS 13, 25–27 (2009), *available at* http://webarchive.nationalarchives.gov.uk/+/http://www.hm-treasury.gov.uk/d/walker_review_261109.pdf; *see also* Financial Reporting Council, The UK Stewardship Code (2010) (implementing Walker's recommendation through a code for institutional shareholders enforced on a "comply or explain" basis). For additional background on the Walker Report and the UK Stewardship Code, see Bruner, *supra* note 26, at 318–19.

Other post-crisis reform initiatives advocating greater shareholder powers in financial firms reflect essentially the same contradiction. *See, e.g.*, GROUP OF THIRTY, *supra* note 27, at 70–74; ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, CORPORATE GOVERNANCE

This contradiction is just as glaring in the United States, where more fundamental initiatives to strengthen shareholders are afoot—most notably through the Dodd-Frank Act, which includes say-on-pay (and golden parachute) votes, enhanced disclosures on "the relationship between executive compensation actually paid and the financial performance of the issuer," and clear authority for the SEC to enact a proxy access regime.[128] How any of this is supposed to reduce risk-taking remains entirely unclear—though the Dodd-Frank Act also requires risk committees in certain larger financial firms and imposes additional regulation for incentive-based pay in financial firms that regulators believe "could lead to material financial loss to the covered financial institution."[129]

The joint efforts of seven financial regulators to implement this requirement, however, have only further demonstrated the lack of a coherent overarching reform strategy. In April 2011, these regulators jointly proposed rules that would require firms with over $1 billion in assets to "balance risk and financial rewards" in setting compensation. Exactly how firms are supposed to do this remains unclear, though illustrative options include deferral (required for firms with over $50 billion in assets), as well as "risk adjustment of awards, reduced sensitivity to short-term performance, or longer performance periods." The fact that we lack a clear sense of how to "balance risk and financial rewards" in enormous financial institutions facing an increasingly shareholder-centric corporate governance framework is tacitly acknowledged, however, when the regulators emphasize that their suggestions "are not exclusive, and additional methods or variations of these approaches may exist or be developed." They add that methods "for making compensation sensitive to risk-taking are likely to evolve during the next few years."[130] Effectively, the combined thinking of seven financial regulators, comprising fifty pages of the *Federal Register*, amounts to little more than a directive to reduce risk-taking. How, exactly, is that to be done? "We don't know," our regulators implicitly reply. "You figure it out." In the meantime, howev-

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AND THE FINANCIAL CRISIS: CONCLUSIONS AND EMERGING GOOD PRACTICES TO ENHANCE IMPLEMENTATION OF THE PRINCIPLES 9, 17, 24–25 (2010).

128. Dodd-Frank Wall Street Reform and Consumer Protection Act, H.R. 4173, 111th Cong. §§ 951, 953, 971 (2010).

129. *Id.* §§ 165(h), 956.

130. Incentive-Based Compensation Arrangements, 76 Fed. Reg. 21170, 21179, 21215–21216 (proposed Apr. 14, 2011) (jointly issued by the SEC; the Department of Treasury, Office of the Comptroller of the Currency and Office of Thrift Supervision; the Federal Reserve System; the Federal Deposit Insurance Corporation; the National Credit Union Administration; and the Federal Housing Finance Agency).

er, Congress works at cross purposes by rendering these financial institutions more directly answerable to risk-preferring shareholders.[131]

That we would respond to a crisis thought to have resulted from excessive financial risk by empowering the corporate constituency most strongly favoring financial risk reflects just how narrow and ossified our conception of the social and economic purpose of financial institutions has become in recent decades. As described above, generating returns for financial firm shareholders has increasingly crowded out all other interests, and this cramped conception of the purpose of financial firms has greatly constrained our sense of the possible in the wake of the crisis. Armed with a diminished vocabulary for describing the relationship between corporate governance and financial risk—and correlatively, a much smaller conceptual toolbox for constraining excessive risk-taking through corporate law—we have found ourselves unable to tackle a set of problems requiring the ability to think creatively about how the corporate architecture ought to be structured.

Widespread popular belief that shareholder interests represent the ultimate aim of the corporation renders it considerably more difficult to perceive and grapple with those circumstances where the shareholders—or at least their incentives—are themselves a substantial part of the problem. While shareholder-wealth maximization never has, and does not currently, represent the singular legal purpose of corporations in the United States, that is only partly relevant because if enough people believe that it does, then it can be expected to constrain the politics of corporate governance reform moving forward. This form of self-fulfilling prophecy has clearly been at work in the wake of the crisis, the result to

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131. *Cf.* Adams & Mehran, *supra* note 23, at 136 n.5 ("In theory, there is a conflict between the objectives of regulators—safety and soundness—and those of shareholders—value maximization. When a conflict exists between value maximization and the need to support prudent operations, regulators expect [bank] boards to balance these concerns effectively. . . . Little is known as to how these conflicts affect the ability of top management and boards of directors to serve these potentially divergent interests.").

That the financial community has no idea what to make of all this—or what its effect on risk-taking will prove to be—is evident from a recent survey of financial-services executives prompted by such reforms. The survey of "almost 90 senior human resource executives at leading financial services companies," conducted by Towers Watson, found that "companies are evenly divided on the impact that the current regulatory environment is having on risk taking in the industry." While half of those polled "said pay structure regulations have had at least a moderate impact," the other half "see little or no impact on risk taking in their organizations resulting from the recent regulations." *See Pay Regulation Prompting Financial Services Companies to Sharpen Their Focus on Talent, Towers Watson Poll Finds*, TOWERS WATSON (June 18, 2012), http://www.towerswatson.com/united-states/press/7327. Just seven percent thought "the new regulatory structure has had a significant impact," and just seven percent thought that "pay structure regulation has fundamentally changed the industry's approach to risk taking." *Id.* This lack of consensus is entirely predictable given the lack of clarity in the proposed rules regarding how risk and financial reward are to be balanced.

date being a series of shareholder-centric reforms that, if anything, are more likely to cause further crises than prevent them.

IV. RE-CONCEPTUALIZING CORPORATE PURPOSE IN FINANCIAL FIRMS

While a comprehensive reckoning of the causes and consequences of the crisis has yet to emerge, it is increasingly clear that excessive risk-taking to boost the stock prices of financial firms must play a central role in any coherent explanation. Wide-ranging financial reforms will be required to address the numerous regulatory failures that contributed to the crisis, [132] and identifying effective reforms—let alone implementing them—will understandably take time. Nevertheless, we can and should begin to direct our attention to corporate governance-driven risk incentives in a meaningful way. Sooner or later that will require revisiting the fundamental issue of whether shareholder interests and incentives really constitute a socially beneficial touchstone for corporate governance in financial firms.

Jonathan Macey and Maureen O'Hara, writing in 2003, presciently observed that "[p]erhaps the most acute corporate governance problem that banks face is the incentive of shareholders to transfer wealth to themselves from fixed claimants such as depositors and government insurers by increasing the riskiness of the business." Accordingly, they argued for reinvigoration of fiduciary duties in the financial context as a check on risk-taking and specifically that "focus[ing] attention on one particular non-shareholder constituency—fixed claimants—appears to be a superior corporate governance model for the banking industry."[133] In a similar spirit, others have argued that we need to reinvigorate shareholder liability as a check on risk-taking. Peter Conti-Brown, for example, has advocated an elective regime under which shareholders in systemically important banks could choose either to expose themselves to double liability or to expose the bank to heightened capital requirements.[134] Claire Hill and Richard Painter have likewise advocated resurrecting personal liability for investment bankers—either through contract or through assessable stock.[135]

Proposals like these are well worthy of consideration, and of course they are not mutually exclusive. Indeed, as the foregoing discussion demonstrates, all of these proposals have direct antecedents in U.S. corporate law, which historically responded to the unique challenges of fi-

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132. For a detailed overview of numerous contributing factors, see ROBERT POZEN, TOO BIG TO SAVE? HOW TO FIX THE U.S. FINANCIAL SYSTEM (2010).

133. Macey & O'Hara, *supra* note 26, at 326, 340.

134. *See generally* Conti-Brown, *supra* note 59.

135. *See generally* Hill & Painter, *supra* note 60.

nancial firm corporate governance with innovations aimed directly at those aspects of the traditional corporate architecture tending to incentivize excessive risk-taking. What these various proposals have in common is a refreshing willingness and ability to think creatively about corporate architecture—to critique and re-conceptualize those structural aspects of the modern corporation that demonstrably ran amok in the recent crisis.[136]

This commonality, however, points toward a fundamental and pressing social and political problem, which is precisely that the marketplace, as well as our legislators, regulators, and judges, now effectively lack this creative capacity, having lost sight of the underlying corporate-purpose debate toward which such proposals gesture. For over a century, our misgivings regarding shareholders were at their greatest in the financial context and for good reasons. It is the context in which we ought to be most concerned about allowing the shareholders' preference for risk to go unchecked. Yet, if anything, we seem to have swung to the opposite extreme over recent decades and find ourselves paying a heavy price for it.

Until we firmly combat the growing popular misconception that financial firms exist merely to maximize stock price for the benefit of their shareholders, we will at best fail to address the core problem and at worst endure similar crises in the future. Only a broader conception of corporate purpose can provide the intellectual grounding for truly effective risk reduction in U.S. financial firms. Unfortunately, our recent reform politics suggest that further crises may be what it takes to drive this lesson home.

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136. While I emphasize the structural creativity of such proposals, other risk-reduction strategies are clearly important and well worth pursuing in their own right—notably those aimed at reducing the effect of financial firm stock price on executive compensation. *See, e.g.*, Bebchuk & Spamann, *supra* note 105, at 283–85 (proposing "compensation based on the value of a broader basket of securities representing a larger part of the corporate pie," including common stock, preferred stock, and bonds); Tung, *supra* note 104, at 1226–41 (proposing compensation in the form of the bank's own "publicly traded subordinated debt"). Some proposals involve innovative design features aimed at rendering the securities themselves more sensitive to the firm's financial stability. *See, e.g.*, Jeffrey N. Gordon, *Executive Compensation and Corporate Governance in Financial Firms: The Case for Convertible Equity-Based Pay* 11–14 (Columbia Law Sch. & European Corp. Governance Inst., Working Paper No. 373, 2010), *available at* http://ssrn.com/abstract=1633906 (proposing "compensation in the form of equity that will convert into subordinated debt upon certain external triggering events" indicating financial distress); Wulf A. Kaal, *Contingent Capital in Executive Compensation*, 69 WASH. & LEE L. REV. 1821, 1854–68 (2012) (proposing compensation in the form of "contingent convertible bonds" triggered earlier than those held by investors in order "to establish an early warning system that is independent of the capitalization needs of the entity"). Others, meanwhile, have identified short-term pressures arising from entirely distinct areas of law. *See, e.g.*, Salter, *supra* note 91, at 23–26 (advocating further study of the potential to incentivize long-term shareholding through favorable tax treatment of long-term capital gains).