HOW THE STRONG NEGOTIATING POSITION OF WALL STREET EMPLOYEES IMPACTS THE CORPORATE GOVERNANCE OF FINANCIAL FIRMS

Bernard S. Sharfman †

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† Mr. Sharfman is a article graduate of the Georgetown University Law Center (2000) and an adjunct professor of business law at the George Washington University School of Business. The opinions expressed in this are solely the author's and are not to be taken as representative of the opinions of any former, current, or future employer. This article is dedicated to Mr. Sharfman's wife, Susan Thea David, and his daughter, Amy David Sharfman, for without their love and encouragement this article would never have been completed. Mr. Sharfman would like to thank Judge Richard A. Posner and Professors Stephen M. Bainbridge, John R. Boatright, Erik F. Gerding, Marc Hodak, Michael D. Klausner, Andrew C.W. Lund, David Rosenberg, Andrew Tuch, P.M. Vasudev and Edward Waitzer for their helpful comments and insights. The initial ideas forming this article were first presented at the Loyola University (Chicago) Conference on Risk Management and Corporate Governance (October 2009).

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ABSTRACT

Several prominent figures in the field of corporate governance have put the blame for the financial crisis of 2008 squarely on the shoulders of greedy shareholders. Moreover, they argued that the financial crisis of 2008 was the result of directors and managers of financial firms focusing too strongly on the short-term interests of their shareholders. If so, the financial crisis can be understood as a corporate governance failure relating to a pernicious form of shareholder primacy.

Yet, how can that argument be reconciled with the behavior of Wall Street firms in regard to the large bonus payments they made to their employees in the years just prior to and during the financial crisis, a time when financial and economic conditions were clearly deteriorating? A better argument, at least for Wall Street firms such as Bear Stearns, Merrill Lynch, and Lehman Brothers, and other financial sector firms where trading, investment banking and asset management was a significant source of firm profitability, is that it was not an overzealous desire to meet the short-term demands of shareholders that was at work in the corporate governance of these firms, but the need to accommodate strongly-positioned non-shareholder parties such as traders, investment bankers and asset managers (Wall Street employees)—parties who acquired their strong negotiating position by possessing the critical assets needed by their respective firms, who did not need to make firm-specific investments and whose skills were highly valued by competing firms.

The implications of this argument are significant for Wall Street firms and other financial firms where Wall Street employees provide a significant source of firm profitability. First, the gap-filling role of shareholder primacy can be understood as being crowded out by the economic terms demanded by those employees who have strong bargaining power. Second, shareholder empowerment proposals implemented to enhance board accountability such
as say-on-pay, annual election of directors and shareholder nomination of
directors may result in negatively affecting shareholder wealth. Finally,
shareholder lawsuits seeking compensation from directors and executive
management for wrongs perceived to have resulted from a lack of attention
to shareholder interests may be unwarranted.

I. INTRODUCTION

SEVERAL prominent figures in the field of corporate governance have put
the blame for the financial crisis of 2008 squarely on the shoulders of
greedy shareholders. For example, Vice Chancellor Leo E. Strine Jr. of the
Delaware Court of Chancery has stated:

Whatever the possible causes of the recent financial debacle, it
seems clear that there is one cause that can be ruled out: that the
directors and managers of the failed firms were unresponsive to
investor demands to take measures to raise profits and increase
stock prices.

Rather, to the extent that the crisis is related to the relationship
between stockholders and boards, the real concern seems to be
that boards were warmly receptive to investor calls for them to
pursue high returns through activities involving great risk and
high leverage.¹

Moreover, they have argued that the financial crisis of 2008 was the result of
directors and managers of financial firms focusing too strongly on the short-
term interests of its shareholders.² According to Martin Lipton and Theodore
N. Mirvis of the New York City law firm of Wachtell, Lipton, Rosen and
Katz and Professor Jay W. Lorsch of the Harvard Business School:

Excessive stockholder power is precisely what caused the short-
term fixation that led to the current financial crisis. As

1. Leo E. Strine Jr., Why Excessive Risk-Taking is Not Unexpected, N.Y. TIMES DEALBOOK (Oct.
   5, 2008), available at http://dealbook.blogs.nytimes.com/2009/10/05/dealbook-
dialogue-leo-strine/ (on file with the Virginia Law & Business Review Association).
2. Id. See also Martin Lipton, Jay W. Lorsch & Theodore N. Mirvis, Schumer’s Shareholder Bill
   Misses the Mark, WALL. ST. J. (May 12, 2009), at A15, available at
stockholder power increased over the last 20 years, our stock markets also became increasingly institutionalized. The real investors are mostly professional money managers who are focused on the short term.

It is these shareholders who pushed companies to generate returns at levels that were not sustainable. They also made sure high returns were tied to management compensation. The pressure to produce unrealistic profit fueled increased risk-taking. And as the government relaxed checks on excessive risk-taking (or, at a minimum, didn't respond with increased prudential regulation), stockholder demands for ever higher returns grew still further. It was a vicious cycle.

Thoughtful observers of corporate governance have recognized the direct causal relationship between the financial meltdown and the short-term focus that drove reckless risk-taking.\(^3\)

If so, the financial crisis can be understood as a corporate governance failure relating to a pernicious form of shareholder primacy.\(^4\) Yet, how can that argument be reconciled with the behavior of Wall Street firms\(^5\) in regard to bonus payments made to their employees in the years just prior to and during the financial crisis, a time when financial and economic conditions were clearly deteriorating?\(^6\) For example, in 2007, the

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3. Lipton, Lorsch & Mirvis, supra note 2.
4. For a definition of shareholder primacy, see infra text accompanying notes 18–21.
5. In the context of this article, Wall Street firms include those companies, such as Goldman Sachs, Merrill Lynch, Morgan Stanley, Lehman Brothers, and Bear Stearns, that were heavily dependent on trading, investment banking and asset management for their profit generation. Other financial sector firms such as Citigroup, J.P. Morgan and AIG also relied heavily on such activities for their profitability, but are distinguished from Wall Street firms by having significantly greater business line diversification.
6. GDP growth was sluggish during the years of 2001 to 2009 with annual growth peaking at 3.0% in 2004. See Bureau of Economic Analysis, National Income and Product Accounts Table, Table 1.1.1. Percent Change From Preceding Period in Real Gross Domestic Product (Feb, 26, 2010), available at http://www.bea.gov/national/nipaweb/TableView.aspx?SelectedTable=1&Freq=Year&FirstYear=2001&LastYear=2009&Freq=Qtr (on file with the Virginia Law & Business Review Association). Moreover, The S&P/Case-Shiller U.S. National Home Price Index hit a peak in the second quarter of 2006 and declined in every subsequent quarter through at least the fourth quarter 2009. Press Release, S&P Indices, Home Prices Continue to Send Mixed Messages as 2009 Comes to a Close.
The top five Wall Street firms: Goldman Sachs, Merrill Lynch, Morgan Stanley, Lehman Brothers, and Bear Stearns, paid a record $39 billion in bonuses, up from $36 billion in 2006. Moreover, Wall Street cash bonuses, paid just to securities industry employees who worked in New York City, were estimated to total $25.6 billion in 2005; $34.3 billion in 2006; $33 billion in 2007; $17.4 billion in 2008, a year in which Lehman Brothers went bankrupt, Merrill Lynch and Bear Stearns had to find merger partners because of extreme financial difficulty, Wall Street firms combined to lose tens of billions of dollars, and billions of taxpayer dollars went to bail out Wall Street firms; and $20.3 billion in 2009. If a pernicious form of shareholder primacy was at work, why weren’t these monies being directed to shareholders either in the form of retained earnings or dividends, resulting in decreased compensation, increased liquidity and increased financial accounting profitability? Therefore, short-term interests may have been at work, but they weren’t coming from the demands of shareholders.


9. Bonus estimates are based on cash bonus payments and deferred compensation for which taxes have been prepaid in each year. The estimates do not include stock options that have not yet been realized or other forms of deferred compensation. Press Release, The Office of the N.Y. State Comptroller, DiNapoli: Wall Street Bonuses Rose Sharply in 2009 (Feb. 23, 2010), available at http://www.osc.state.ny.us/press/releases/feb10/022310.htm.

10. Press Release, The Office of the N.Y. State Comptroller, New York City Securities Industry Bonus Pool (Feb. 23, 2010), available at http://www.osc.state.ny.us/press/releases/feb10/bonus_chart_2009.pdf. It is important to note that these numbers underestimate the true amount of bonuses paid out to Wall Street employees as the bonuses paid by New York City—based firms to their employees outside of the City (whether in domestic or international locations) are not included. Id. Moreover, the bonus payouts in 2009 were significantly below expectations as Wall Street succumbed to strong public and regulatory pressure to keep the bonuses under control. Susanne Craig, Goldman’s Pay Restraint Helped Drive Record Year, WALL ST. J., Jan. 21, 2010, http://online.wsj.com/article/SB100014240527487036099204575016804205358736.html (on file with the Virginia Law & Business Review Association).
The primary purpose of this essay is to argue that for Wall Street firms such as Goldman Sachs, Merrill Lynch, Morgan Stanley, Lehman Brothers, and Bear Stearns, and other financial sector firms that relied heavily on trading, investment banking and asset management for their profitability prior to and during the financial crisis of 2008, it was not an overzealous desire to meet the short-term demands of shareholders that was at work in the corporate governance of these firms, but the need to accommodate strongly positioned non-shareholder parties such as traders, investment bankers and asset managers (Wall Street employees), parties who acquired their strong negotiating position by possessing the critical assets needed by their respective firms, who did not need to make firm-specific investments and whose skills were highly valued by competing firms.

Such a balance of power allowed for shareholder primacy to exist as the corporate objective, but minimized its significance in corporate decision-making. This meant that it was not a corporate governance failure when Wall Street firms continued to pay out large bonuses during troubled times, but simply a rational response to the demands of the labor markets in which they operated. This argument is consistent with Professor Gordon Smith’s contention that in many cases the hands of corporate leaders are essentially tied, as “the existence of powerful product markets, capital markets, and managerial labor markets restricts the options of corporate decision makers, thus frustrating attempts to materially alter the substance of corporate actions.”

Therefore, what is critical in corporate governance is not just the recognition that shareholder primacy exists, but appreciating the actual impact it has on corporate decision-making.

The implications of this argument are significant for Wall Street firms and other financial firms where Wall Street employees provide a significant source of firm profitability. First, the gap-filling role of shareholder primacy can be understood as being crowded out by the economic demands of employees with strong bargaining power. Second, shareholder empowerment proposals implemented to enhance board accountability such as say-on-pay, annual election of directors, and shareholder nomination of directors may negatively affect shareholder wealth. Finally, shareholder lawsuits seeking compensation from directors and executive management for wrongs perceived to have resulted from a lack of attention to shareholder interests may be unwarranted.

This essay views the firm as a nexus of contracts. By taking this approach, the contractual issues involving shareholder primacy and the relative negotiating power of shareholders become easily understood. In regard to the implications for corporate law, the discussion is meant to apply generally to all jurisdictions with their own corporate law (or its equivalent), both domestically and internationally. Nevertheless, the discussion has been pragmatically framed in the context of Delaware corporate law. Delaware is the state where the majority of the largest U.S. companies are incorporated, and its corporate law often serves as the authority that other U.S. states look to when developing their own statutory and case law. Therefore, the primary examples are from Delaware, but the analysis is meant to be global in nature. Finally, this essay is meant to apply only to a public company where the board is presumptively made up of a majority of members that are both independent and disinterested.

Part II describes the role played by shareholder primacy in corporate governance. Part III argues that the strong negotiating position of Wall Street employees has reduced the significance of shareholder primacy in the corporate governance of Wall Street firms and those financial sector firms where such employees provide a significant source of firm profitability. Part IV discusses the implications for corporate governance, including the gap-

12. See infra Part II.
15. A public company or publicly held firm is an economic organization in which (i) management and shareholding are separable and separated functions; (ii) the shares are held by a number of persons; and (iii) the shares are freely transferable. Michael P. Dooley, Two Models of Corporate Governance, 47 Bus. Law. 461, 463 n.9 (1992).
16. For a public company to be listed on a major stock exchange, a majority of its board members must meet minimum exchange requirements for independence. For example, the New York Stock Exchange requires a public company’s board to have a majority of independent directors and that the major corporate board committees—audit, compensation, and nominating—be composed entirely of independent members. See NYSE, Inc., Listed Company Manual §§ 303A.0201–303A.07 (2009).
17. A disinterested director is “not concerned, in respect to possible gain or loss, in the result of the pending proceedings or transactions.” Black’s Law Dictionary 469 (6th ed. 1990).
filling role of shareholder primacy and the effects on shareholder empowerment and corporate law. Part V provides a brief conclusion.

II. THE ROLE OF SHAREHOLDER PRIMACY IN CORPORATE GOVERNANCE

Shareholder primacy is a norm\(^{18}\) that requires the primary objective of a public company to be maximization of shareholder value.\(^{19}\) This means that “[d]ecisions about such things as new investments, strategic direction, and corporate strategy should be effectuated for the shareholders . . . .”\(^{20}\) There is a broad but not universal consensus that shareholder primacy should be both the norm and default rule underlying the corporate governance of public firms.\(^{21}\) Among those who disagree with this broad consensus are Professors Margaret Blair and Lynn Stout. They have argued that shareholder primacy does not apply when stakeholders make firm-specific investments in the firm.\(^{22}\) Firm-specific investments are “irrevocable commitment(s) of resources to the joint enterprise,”\(^{23}\) and are made by executives, rank-and-file employees, and equity investors, but can also include researchers, creditors, the local

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18. A norm can be described as “‘a rule that is neither promulgated by an official source, such as a court or legislature, nor enforced by the threat of legal sanctions, yet is regularly complied with.’” Jonathan R. Macey, Corporate Governance: Promises Kept, Promises Broken at 32–33 (2008) (quoting Richard A. Posner, Social Norms and the Law: An Economic Approach, 87 Amer. Econ. Rev. 365 (1997)).

19. Id. at 5. How shareholder primacy is defined is important because shareholder primacy is sometimes associated with other concepts besides shareholder wealth maximization. Professor Stephen Bainbridge made this very important observation when explaining how his director primacy model of corporate law rejected shareholder primacy even though it incorporated the shareholder wealth maximization norm. Stephen M. Bainbridge, The Board of Directors as Nexus of Contracts, 88 Iowa L. Rev. 1, 6 (2002). For example, some shareholder primacy advocates believe that shareholders are the true owners of the corporation and not just one factor of production bound to the other factors through contract. Id. Or, they may believe that directors and executives are simply agents of shareholders bound together in a principal-agent relationship. Id. This principal-agent model views the public company as “bundles of assets collectively owned by shareholders (principals) who hire directors and officers (agents) to manage those assets on their behalf.” Margaret M. Blair & Lynn A. Stout, A Team Production Theory of Corporate Law, 85 Va. L. Rev. 247, 248 (1999) (seminal work on team production and corporate law). As used here, these additional concepts are not included in the definition of shareholder primacy.

20. Macey, supra note 18, at 7.

21. Id. at 4.

22. Blair & Stout, supra note 19, at 249.

23. Id. at 272.
community, marketers, and vendors who provide specialized products and services to the firm and shareholders, among others. Stakeholders are willing to make firm specific investments because they give rise to implicit contracts that provide them with residual claims on the net cash flows of the corporation, just like the residual claims held by shareholders. The board must honor these implicit contracts or else face a reduced investment or disinvestment in the corporation by those stakeholders who allow the company to prosper. When this occurs, shareholder primacy does not apply. However, as will be subsequently discussed, there is no evidence of significant firm-specific investments being made by Wall Street employees.

Shareholder primacy is provided a special seat of prominence in a worldview where the corporation is understood as a “nexus of contracts” and “economic efficiency is the normative guidepost” for corporate governance. This is demonstrated when describing the “corporate contract”:

The “corporate contract” is the metaphorical contract consisting of the sum of the voluntary arrangements among the various parties who contribute resources to the corporate enterprise and

24. Id. at 276 n.61.
25. Id. at 314, n.178. Any person or entity that makes a firm-specific investment, but is “unable to protect [that investment] by direct contracting, personal trust, or reputation,” has a residual claim on the firm. Lynn M. LoPucki, A Team Production Theory of Bankruptcy Reorganization, 57 VAND. L. REV. 741, 749 (2004).
27. How the board must act when shareholder primacy does not apply is explained by Professors Blair and Stout. Id. at 249. In their understanding of corporate governance, the board of directors, composed primarily of independent and disinterested members, provides a unique mediating function. Not only does it have the final authority on hiring and firing corporate officers, approving corporate policy, recommending major transactions for shareholder approval, approving executive compensation packages, and more, but it also acts “as an internal ‘court of appeals’ to resolve disputes that may arise among the team members.” Id. at 276–77. In this role, board members are “mediating hierarchs whose job is to balance team members’ competing interests in a fashion that keeps everyone happy enough that the productive coalition stays together.” Id. at 281.
have claims against it. Discovering the correct gap-filling principles for the corporate contract involves hypothetical bargain analysis—asking what contractual terms rational parties would have agreed to had they addressed ex ante the matter that falls into a contractual gap. For corporate contracts, the prevailing view is that this gap-filling principle should be “maximize shareholder value.”

A nexus-of-contracts understanding of the corporation does not require shareholder primacy to be the default rule when there are contractual gaps. Everything is negotiable among the parties contracting with the corporation, including its objectives and purpose. The filling of the contractual gaps results from a hypothetical negotiation where it is assumed that the parties reach agreement on all contract terms and that the contracts can be enforced at no cost. Nevertheless, it is clear that shareholder primacy is the agreed upon default rule when it is assumed that all of the corporation’s contracts are complete except for the firm’s contract with shareholders. Complete contracts “specify all the future payoff-relevant contingencies.” Therefore, those who enter into complete contracts would be “contractually protected against any negative consequence.” These parties are completely protected from loss even if the firm went out of business as either their services would be redeployed at the same price at other firms or they would be compensated up-front for their losses. However, the contract with shareholders is anything but complete. Shareholders part with their money in exchange for the expectation of future returns, but without any guaranteed returns.

33. See Macey, supra note 18, at 45.
Moreover, it is the board of directors—not shareholders—that decides if a dividend will be paid, and how much the dividend will be.\(^39\)

In a world where all parties are protected by contract except for shareholders, shareholders are truly the sole residual claimants to the net cash flows of the firm. As residual claimants, shareholders take on the residual risk, i.e., “the risk of the difference between stochastic inflows of resources and promised payments to agents,” and in exchange receive the right to receive the net cash flows of the corporation.\(^40\) Since shareholders bear risks from discretionary decisions made by the corporation, shareholders would require shareholder primacy as part of the hypothetical bargain with the firm’s other parties.\(^41\) In practice, this would mean that all major decisions such as compensation policy, new investments, dividend policy, strategic direction and corporate strategy should be implemented based on the best interests of shareholders.\(^42\) Moreover, where all contracts are explicit and complete except for those with shareholders, the maximization of social welfare is directly linked to the maximization of shareholder value.\(^43\)

However, in practice, contracts are never really complete with non-shareholder parties. It is just too costly when writing up a contract to specify all the future payoff-relevant contingencies.\(^44\) But even if these contracts cannot be made complete, most corporate law contractarians would still argue that shareholder primacy must be the default rule because the gaps in the shareholder contract are significantly greater than those found in the contracts of other parties contracting with the firm.\(^45\) According to Professors Fama and Jensen, “the contract structures of most organizational forms limit the risks undertaken by most agents by specifying either fixed promised payoffs or incentive payoffs tied to specific measures of performance.”\(^46\) For example, bondholders have a much more detailed contract with the firm than shareholders.\(^47\)

\(^39\) See Blair & Stout, supra note 19, at 291.
\(^40\) Fama & Jensen, supra note 36, at 3.
\(^41\) See Mahoney, supra note 35, at 10.
\(^42\) Macey, supra note 18, at 7.
\(^43\) See Easterbrook & Fischel, supra note 28, at 38. From a more intuitive perspective, shareholder primacy can be thought of as the norm guiding corporate law because it is the “operational assumption of successful firms.” Id. at 36.
\(^44\) See Smith, supra note 29, at 232.
\(^45\) See id. at 233–34.
\(^46\) Fama & Jensen, supra note 36, at 3.
\(^47\) See Smith, supra note 29, at 233.
III. WHEN SHAREHOLDER PRIMACY IS AFFECTED BY THE NEGOTIATING POWER OF WALL STREET EMPLOYEES

The assumption of complete contracts for non-shareholders creates a simplified world that makes it very easy for a board to understand that their decisions need to be geared toward benefiting shareholders. More importantly, the relative completeness of contracts with non-shareholder parties probably reflects the environment in which a significant number of public companies operate or have operated, fortifying the argument that shareholder primacy should be the norm and default rule of corporate governance. However, as discussed below, even though shareholder primacy is shown to have been the corporate objective of Wall Street firms, the strong negotiating position of Wall Street employees made it difficult for shareholder primacy to overcome the demands of these powerful non-shareholder parties.

A. Why Shareholder Primacy Applied

Consider a firm that enters into cash bonus oriented compensation contracts with its employees with terms that can be either explicit or implicit. The explicit contract guarantees an employee a small fixed wage plus the potential for a large annual cash bonus based on meeting or exceeding clearly defined performance goals. The implicit contract also provides a small fixed wage but only an implicit understanding that a good faith effort will be made at the end of the year to pay out a significant cash bonus based on meeting clearly defined performance goals. Compensation arrangements that focus on large end-of-the-year cash bonuses have always been associated with firms organized as partnerships, but it was not until the

48. See Blair, supra note 38, at 233.
49. It is understood that Wall Street firms provided cash bonus oriented compensation contracts with terms that can be either explicit or implicit and that some firms favor one type of contract over the other. For example, it appears that Goldman Sachs relied heavily on implicit contracts, given that Goldman Sachs was on pace to pay out approximately $700,000 in bonuses per employee based on accruals for the first nine months of 2009. Graham Bowley, Bonuses Put Goldman in Public Relations Bind, N.Y. TIMES, October 16, 2009, at B1. But then, as a result of public and regulatory pressure, the firm paid out only $500,000 per employee ($3 billion less than expected). Susanne Craig, Goldman’s Pay Restraint Helped Drive Record Profit, WALL ST. J., January 22, 2010, at C1. Unfortunately, since the details of these contracts are not publicly disclosed, it is difficult to statistically describe their use.
financial crisis of 2008 that it became apparent how important such contracts were to publicly traded Wall Street firms.\textsuperscript{50}

For Wall Street employees, annual compensation can be highly volatile. Traditionally, \textit{sixty percent} of a Wall Street employee's compensation comes from his or her annual bonus.\textsuperscript{51} Cash bonuses for securities industry employees who worked in New York City averaged between $99,200 and $191,360 for the years 2005 to 2009.\textsuperscript{52} Such volatility is evidence of the incompleteness of their contracts, even though they are much more complete than the contracts entered into by shareholders.\textsuperscript{53} However, the bonus practices on Wall Street are not standardized. While these bonuses could be based solely on firm performance, they could just as easily have been a function of the annual income booked by an employee within his or her business unit,\textsuperscript{54} or by his or her team, or a combination of all three.

Even though Wall Street employees have incomplete contracts, and, based on the type of contract entered into, potentially volatile claims on the net cash flows of the firm, it is hard to argue that shareholder primacy should not be the hypothetical bargain between the parties that make up the web of contracts that we call the firm. First, the contracts entered into by these employees may be incomplete, but they do not compare to the incomplete nature of shareholder contracts. As Professor Jonathan Macey observed,\textsuperscript{53}

\begin{itemize}
\item \textsuperscript{52} Press Release, Office of the N.Y. State Comptroller, \textit{supra note 10}. This data understates the variability in bonus compensation per employee per firm. For example, in 2008, a trough year for bonuses, especially for cash bonuses at the executive level, Goldman Sachs paid out $4.82 billion in bonuses, of which $2.24 billion was in cash, providing 953 employees with at least $1 million each with 78 of those employees earning $5 million or more. At J.P. Morgan Chase, $8.693 billion in bonuses were paid out, of which $5.908 billion was in cash, providing 1,626 employees with at $1 million each with 84 of those employees receiving $5 million or more. Press Release, Andrew M. Cuomo, N.Y. Att'y Gen., \textit{No Rhyme or Reason: The 'Heads I Win, Tails You Lose' Bank Bonus Culture} (July 30, 2009), \textit{available at} http://www.ag.ny.gov/media_center/2009/july/pdfs/Bonus\%20Report\%20Final\%207.30.09.pdf (on file with the Virginia Law \\& Business Review Association).
\item \textsuperscript{53} See Macey, \textit{supra note 18}, at viii.
\end{itemize}
“[s]hareholders have almost no contractual rights and virtually no contractual rights to corporate cash flows. Shareholders’ investments are based on trust.” Moreover, as subsequently described, even when the bonus contracts are implicit, firms will be under strong pressure to make significant bonus payments in down years to retain key employees. Second, shareholders need protection from bonus contracts that are not a function of the performance of the firm, but of the microcosm of the firm in which the employees operate. For example, whether in a down year for the firm or when financial and economic conditions are deteriorating, traders will still expect to be paid the ten percent or so of all the income they have booked. When this occurs, part of the bonus payments will most likely come out of the shareholders’ equity. Third, shareholders need protection from bonus arrangements that remove precious capital from the firm. Employees desire their bonuses in cash or easily liquidated securities because, unlike shareholders who can diversify away their firm-specific risk, they cannot diversify away the firm-specific risk associated with their source of bonus income. Fourth, there is no evidence that Wall Street employees made significant firm-specific investments at Wall Street firms that would give rise to significant residual claims on the net cash flows of the firm. Wall Street employees possess critical skills and abilities (“critical assets”) that can be assumed to be fully transferable to other firms and therefore not dependent on the assets of any particular firm. As previously discussed, evidence of significant firm-specific investments would potentially create a situation where shareholder primacy would not apply.

The web of contracts just described is one where shareholders possess little in the way of contractual protections, putting in doubt a rational basis for their investment in such a firm if shareholder primacy did not exist. Therefore, based on all the above factors, a strong argument can be made that

55. Macey, supra note 18, at vii.
56. See infra, notes 71–79.
57. According to Roger Ehrenberg, “Depending upon level, experience and one’s ‘deal,’ trader payouts generally range from, say 8% to 15% of P&L, with 10%–12% likely the fat part of the distribution.” Ehrenberg, supra note 54.
58. The financial results for Wall Street firms (Citigroup, Goldman Sachs, J.P. Morgan, Merrill Lynch and Morgan Stanley) in 2008 affirm this assertion as bonus compensation did not fall as quickly as net revenues, causing net financial accounting losses at several Wall Street firms. See New York State Comptroller, supra note 9.
59. See supra text accompanying note 9.
60. Blair & Stout, supra note 19.
61. Zingales, supra note 37, at 1641.
it was necessary for shareholder primacy to be the gap filler in the corporate contract.62

B. The Strong Negotiating Position of Wall Street Employees

Why Wall Street employees and their respective firms were so willing to enter into bonus compensation arrangements most likely has a historical basis. In the not so distant past, prior to Wall Street becoming dominated by public firms, Wall Street firms were structured as partnerships that paid out in cash bonuses their respective firms’ residual at year end.63 Surely, this has influenced what traders, investment bankers and asset managers have come to believe to be their optimal form of compensation. As evidence that this may be the case, Goldman Sachs, a large publicly traded company, refers to its 400-plus managing director group as “partner managing directors.”64 If so, the ultimate goal of these employees is to have the status of a partner, even if this position is no longer technically available.

However, even if a partnership-like arrangement is what Wall Street employees desire, the marketplace must still have a reason to be receptive to such arrangements in order for them to become pervasive. This marketplace receptiveness is most likely the result of traders, investment bankers and asset managers being in extremely strong bargaining positions relative to shareholders. Their strong bargaining position results from possessing critical skills and abilities (“critical assets”) that can be assumed to be fully

62. It is conceivable that the strength of the claims of Wall Street employees may be so strong as to create something akin to employee primacy in some of these firms. This may have been the case when Goldman Sachs first went public in 1999 (prior to subsequent public offerings of the company’s stock. See Leah Nathans Spiro, Goldman Sachs: How Public Is This IPO?, BUSINESS WEEK ONLINE, (May 17, 1999), available at http://www.businessweek.com/1999/99_20/b3629102.htm (on file with the Virginia Law & Business Review Association). The result of the IPO was that the former partners owned 48.3% of the firm’s common stock, non-partnership employees owned 21.2%, retired partners and two large institutional investors received 17.9% and the public only 12.6%. Id. At the time, one insider was quoted as saying in regard to the public shareholders, “We’re going to let you in. Now shut up and sit back and we’ll let you know how much you made.” Id. In this scenario, it can be argued that the roles have been reversed and now the duty of the board is to maximize the wealth of those employees with significant residual claims and only provide to shareholders the minimum amount necessary to keep them content.


transferable to other firms and therefore not dependent on the assets of any particular firm.\textsuperscript{65} This lack of firm-specific investment allows them to move easily from firm-to-firm as long as the new firm can provide them the appropriate amount of financing and/or an adequate trading platform.

Compensation arrangements that include the potential for large annual bonuses provide the firm with the reasonable expectation that employees who own critical assets of production will stay at least until the end of the bonus period.\textsuperscript{66} Even though the time horizon is short, the employees are now committed to the company until the bonus is paid out.\textsuperscript{67} If the employees leave prior to payout, they forfeit the accrual value of their expected large bonuses.\textsuperscript{68} This value increases as the bonus date draws near, increasing the commitment of the employees to the firm. Thus, these compensation arrangements have enticed employees to make an investment of time into the firm.

In a sense, because these employees own and control the assets the firm critically needs, these employees act more like independent contractors than employees.\textsuperscript{69} Therefore, in order to tie these independent contractors to the firm and therefore allow the firm to gain control of these assets, these employees are provided what can be thought of as either a unique class of non-voting preferred stock in the form of the expectation of large annual bonuses,\textsuperscript{70} if the bonuses are tied to the net cash flows of the firm, or a unique subordinated debt security if the bonuses are tied to the microcosm of the firm in which these employees work, or a mixture of both types of securities if their bonus arrangements are correspondingly blended.

If the firm does not have ownership of the critical assets required for production, then the firm can no longer think of itself “as a traditional company with clear boundaries defined by its assets.”\textsuperscript{71} Most importantly, it creates a difficult issue for the firm to resolve. That is, how can it retain the critical skills and abilities possessed by these employees when they are not

\begin{footnotesize}
\begin{enumerate}
\item Zingales, supra note 37, at 1641.
\item Sharfman, supra note 50, at 825 n.55.
\item Id.
\item Id.
\item Sharfman, supra note 50, at 825 n.55.
\item Zingales, supra note 37, at 1641.
\end{enumerate}
\end{footnotesize}
dependent on any unique asset of the firm for their productivity and are in essence the valuable assets themselves.\textsuperscript{72}

For a Wall Street firm to have the reasonable expectation that its employees who own the key assets of production will stay longer than a bonus cycle, it is critical for the firm to create a reputation for providing its employees competitive compensation arrangements year-in-and year-out. That is, if employees do not get the bonus terms they believe other firms are willing to provide them (explicit contracts, ex ante) or what they think they deserve in the way of bonuses at the end of the year (implicit contracts, ex post),\textsuperscript{73} they may threaten to leave the firm and break up the team.\textsuperscript{74} This threat is strongest when the employees own the critical assets of production.\textsuperscript{75} The resulting harm to the firm from these employees actually leaving is the likelihood that their replacements will be inferior in skill and profit generating potential.\textsuperscript{76} This can be assumed because the firm will no doubt gain a reputation for not being able or willing to adequately compensate their employees.\textsuperscript{77} Only those prospective employees with lower bonus expectations and presumably lower productivity would apply for the vacated positions.\textsuperscript{78} Thus, the need for Wall Street firms to maintain their reputation for fulfilling their implicit bonus contracts (ex post) as well as maintaining the perception that they have the ability to competitively renegotiate their explicit bonus contracts (ex ante), helps explain why Wall Street firms persisted in paying out huge cash payouts in 2006 and subsequent years despite declining economic and financial conditions.\textsuperscript{79}

\textbf{IV. IMPLICATIONS FOR CORPORATE GOVERNANCE}

As described above, shareholder primacy was critical to protecting the residual interests of shareholders who invested in Wall Street firms. Unfortunately for those shareholders, the balance of power regarding claims

\textsuperscript{72} Id. at 1641, 1644.
\textsuperscript{73} Id. at 1633 (for implicit contracts to be credible, “they require one party (or both) to have established some reputation over time”).
\textsuperscript{74} Sharfman, supra note 50, at 831.
\textsuperscript{75} Baker, Gibbons & Murphy, supra note 69, at 56 (noting how a party’s ability to get a firm to follow through on its implicit contracts is enhanced when the party has control of an asset of production).
\textsuperscript{76} Sharfman, supra note 50, at 831.
\textsuperscript{77} Id.
\textsuperscript{78} Id.
\textsuperscript{79} See supra text accompanying notes 7–10.
on the revenues generated by these firms clearly favored non-shareholders such as traders, investment bankers and asset managers. Such a balance of power allowed for shareholder primacy to exist as the corporate objective, but created an environment where its significance was minimized in corporate decision-making. Therefore, it was not a corporate governance failure when Wall Street firms continued to pay out large bonuses during troubled times, but simply a rational response to the demands of the labor markets in which they operated.

We do not have to look far for other examples of this phenomenon. For example, think of union workers who extract economic rents that exceed their opportunity costs. Or, think of bondholders who, during times of tight credit, receive favorable terms as a result of their negotiating strength. Another example is suppliers or customers who are in a strong bargaining position in a particular firm and therefore are able to negotiate better terms than similarly situated claimants in other firms. All are examples of non-shareholders taking advantage of their strong negotiating positions relative to shareholders.

A. The Crowding Out of Shareholder Primacy

From a nexus of contracts approach, what has happened is that the gap-filling role of shareholder primacy is being crowded out by the economic terms demanded by non-shareholder parties who have strong bargaining power. Shareholder primacy still fills the gaps, but its value to shareholders has been diluted. While most likely not observable, this must have had a negative impact on the magnitude of shareholders’ residual claims and put downward pressure on a Wall Street firm’s stock price. It may also have created the impression that a firm’s management was not doing enough to enhance shareholder value when in reality it was only reacting rationally to market forces.

Understanding the relative negotiating strength of shareholders versus non-shareholders at one’s firm is a key element of good corporate governance. For example, consider the experience of the global advertising firm of Saatchi and Saatchi, a firm analogous to a Wall Street firm as it was

81. Macey, supra note 32, at 1275.
82. Id. at 1267.
composed of significant human capital but little in the way of physical assets and therefore not “a traditional company with clear boundaries defined by its assets.” In 1994, the board of directors proposed to provide Maurice Saatchi, the chairman and co-founder of the firm, with a very generous compensation package that would pay him $1 million a year and $7.5 million if the stock doubled in three years. However, U.S. institutional investors, who held over 30% of the company’s shares, believed that Mr. Saatchi was using his position to opportunistically enrich himself at their expense, and therefore voted down the proposal at the general shareholders’ meeting. The vote led to the departure of Mr. Saatchi. However, it also led to the departure of several key senior executives as well as a number of large accounts, severely damaging the company. In hindsight, shareholders overestimated the strength of their negotiating position by not realizing that the firm’s critical assets, its senior executives, were highly mobile and that Mr. Saatchi had the loyalty of these key assets. Shareholder primacy existed, but its impact had been minimized by Mr. Saatchi’s strong negotiating position.

B. Shareholder Empowerment

Statutory law provides a public company’s board with the authority to manage and execute the various forms of explicit and implicit contracts that encompass a firm’s contractual make-up. Such decision-making authority is all encompassing. However, over the last several years, much attention has been given to shareholder proposals or federal legislation that would give

83. Zingales, supra note 37, at 1641.
84. Id.
86. Id.
87. Zingales, supra note 37, at 1641.
88. Id.
89. Id.
90. Delaware General Corporation Law Section 141(a) provides that “[t]he business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors, except as may be otherwise provided in this chapter or in its certificate of incorporation.” Del. Code Ann. tit. 8, § 141(a) (2001). In practice, board involvement in contractual details rarely occurs as statutory law also allows the board to delegate this authority to executive management. For example, Delaware General Corporation Law section 142(a) provides that “[e]very corporation organized under this chapter shall have such officers with such titles and duties as shall be stated in the bylaws or in a resolution of the board of directors which is not inconsistent with the bylaws.” Del. Code Ann. tit. 8, § 142(a) (2001).
91. Id.
more decision-making authority to shareholders through such mechanisms as a shareholder advisory vote on executive compensation (say-on-pay), shareholder nominated directors, majority voting, the annual election of directors, prohibiting the chief executive officer from also holding the position of chairman, the absence of poison pills, and requiring shareholder approval to amend bylaws.  

Such calls for shareholder empowerment run counter to the traditional argument that the centralized decision-making authority of a public company’s board must be protected from interference from shareholders and the courts. For example, Professors Michael P. Dooley and Stephen M. Bainbridge base such an argument on Kenneth Arrow’s theory that the hierarchical nature of a large organization allows it to “efficiently filter information in its decision-making process” to the public company. According to Arrow, efficiency is created in a large organization because “the centralization of decision-making . . . serves to economize on the transmission and handling of information.” Furthermore, the value of centralized authority provides extra benefits to widely-held public companies. According to Professor Dooley, the value of centralized authority in an organization is magnified as the knowledge and interests of its members diverge. In a public company, information and interests differ between management and shareholders. Especially where there are a large number of shareholders, it is much more efficient for the board of directors, a


93. Dooley, supra note 15; Bainbridge, supra note 19.

94. KENNETH J. ARROW, THE LIMITS OF ORGANIZATION 68 (1974). Professor Michael Dooley was the first to make the connection between the work of Kenneth Arrow and the structure of Delaware corporate law. See Dooley, supra note 15, at 467. Professor Bainbridge has adopted Professor Dooley’s application of Arrow’s theory and readily acknowledges the contribution Professor Dooley has made in the development of his director primacy model. See Stephen M. Bainbridge, The Business Judgment Rule as Abstention Doctrine, 57 VAND. L. REV. 83, 85 n.11 (2004).

95. ARROW, supra note 94, at 69.

96. Dooley, supra note 15, at 466–67. The value of centralized authority is not as great in general partnerships and closely-held corporations because the same persons perform both the managerial and risk-taking (investment) functions. Management and partners or shareholders are essentially one and the same. Id.
centralized authority with an overwhelming information advantage, to make
corporate decisions rather than shareholders.97
This does not mean that the corporate board of a public company should
be allowed to wield its authority without any accountability to shareholders.98
The corporate board needs to be held accountable for its decisions or else it
may act irresponsibly with the “likelihood of unnecessary error.”99 Moreover,
“unaccountable authority may be exercised opportunistically.”100 Therefore, it
is legitimate to criticize such authority and put into place some sort of
“corrective mechanism.”101
Nevertheless, the fear is that in the process of trying to correct errors
resulting from irresponsible decisions, “the genuine values of authority” will
be destroyed.102 Such “a sufficiently strict and continuous organ of
responsibility can easily amount to a denial of authority.”103 Arrow suggests,
“[I]f every decision of A is to be reviewed by B, then all we have really is a
shift in the locus of authority from A to B and hence no solution to the
original problem.”104
As described above, to justify a shift in the balance between board
authority and accountability, an expected net gain in the efficiency of firm
decision-making is required. Shareholder activists believe that shareholder
wealth would be increased if a number of corporate governance practices that
make the board and executive management more accountable to shareholders
were uniformly implemented at public companies.105 Implementing such
practices can be justified where the negotiating position of shareholders is
strong and where there is good cause to believe that the board and executive
management are not adequately addressing shareholder interests.

97. Id. The value of such specialization of function is quite clear. The best managers can be
selected without regard to their ability to finance the company. On the other end of the
spectrum, the shareholder pool is greatly increased as shareholders are not required to
bring decision-making expertise along with their equity capital. See Frank H. Easterbrook
98. Bainbridge, supra note 19, at 7.
100. Bainbridge, supra note 94, at 107.
101. Arrow, supra note 94, at 75.
102. Id. at 78.
103. Id. (emphasis added).
104. Bainbridge, supra note 19, at 7.
105. Nicholas C. Howson, When “Good” Corporate Governance Makes “Bad” (Financial) Firms: The
Global Crisis and the Limits of Private Law, 108 MICH. L. REV. FIRST IMPRESSIONS 44, 45
(2009).
However, implementing such corporate governance practices does not change the balance of power that exists between shareholders and non-shareholders, and if the negotiating power of non-shareholders is strong, such as for Wall Street employees, the practices will most likely have no effect on enhancing decision-making efficiency and therefore no positive effect on shareholders’ wealth. In this situation, the board’s hands are tied in promoting shareholder interests. But perhaps most importantly, the Saatchi and Saatchi example, consistent with the corporate governance models of Dooley and Bainbridge, suggests that shareholder empowerment may lead to increased errors in corporate decision-making. In that example, adverse results for the firm resulted when shareholder involvement compelled the board to ignore the strong negotiating position of Mr. Saatchi. Therefore, decision-making efficiency and shareholder wealth may be negatively affected by an increase in shareholder participation. Moreover, identifying good corporate governance practices requires a firm-by-firm evaluation of the strength of shareholder interests and not a one-size-fits-all approach.106

C. Corporate Law

As in corporate governance, shareholder primacy serves as the norm and default rule in corporate law.107 Moreover, shareholder primacy has been recognized as such by the courts for decades. In the 1919 case of *Dodge v. Ford Motor Co.*, the Michigan Supreme Court provided the following dictum that has been a favorite of academics advocating shareholder primacy:

A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to

106. The Dodd-Frank Act is a good example of a one-size-fits-all approach to the corporate governance of public companies. The statute grants shareholders advisory votes on executive compensation, requires the SEC to adopt rules to make it easier for shareholders to include their own director nominees in company proxy materials and requires that compensation committees be fully independent. *See* Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203 §§ 951, 952 and 971 (2010).

107. Macey, *supra* note 18, at 7 (According to Professor Jonathan Macey, “the clear, longstanding, and unambiguous default rule in corporate law is that corporations are organized to maximize value for shareholders.”); Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 Geo. L.J. 439 (2001) (“There is no longer any serious competitor to the view that corporate law should principally strive to increase long-term shareholder value.”) (emphasis added).
be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end, and does not extend to a change in the end itself, to the reduction of profits, or to the nondistribution of profits among stockholders in order to devote them to other purposes.\textsuperscript{108}

For Wall Street firms, shareholder primacy can be argued to be the corporate objective, but because of the strong negotiating position of traders, investment bankers and asset managers, the ability of Wall Street boards and executive managements to act on shareholder interests has been severely handicapped. Therefore, it should come as no surprise when the press asked the question: “Are investment banks run for employees or shareholders?”\textsuperscript{109} Or, the frustration expressed by the State of New York’s Attorney General in describing compensation practices at the nine original Troubled Asset Relief Program (TARP) recipients:

Thus, when the banks did well, their employees were paid well. When the banks did poorly, their employees were paid well. And when the banks did very poorly, they were bailed out by taxpayers and their employees were still paid well. Bonuses and overall compensation did not vary significantly as profits diminished.\textsuperscript{110}

It should also come as no surprise when the board and certain executive officers of Goldman Sachs, one of the largest and most prominent of Wall Street firms, were recently sued for a breach of fiduciary duties for allegedly not considering the interests of shareholders when providing large bonuses to their executive management team and employees.\textsuperscript{111}


\textsuperscript{110} Cuomo, supra note 52, at 1.

\textsuperscript{111} Shareholder Derivative Complaint, Central Labors’ Pension Fund v. Blankfein, New York State Supreme Court, New York County, No. 600036/2010, (filed January 7, 2010), available at http://iapps.courts.state.ny.us/isroll/SQLData.jsp?IndexNo=600036-2010&Submit=Search (on file with the Virginia Law & Business Review Association). Even though this suit was filed in New York County, the location of Goldman Sachs headquarters, Delaware law still applies as Goldman Sachs is a Delaware corporation.
In filing this shareholder derivative suit for breach of fiduciary duties, the plaintiff could be seen as simply conforming to the prevailing view that fiduciary duties provide a critical gap-filling role in the corporate contract\textsuperscript{112} and that this gap-filling principle should be to maximize shareholder value.\textsuperscript{113} Yet, based on the position taken in this essay, it can be argued that the board and executive of Goldman Sachs have not breached their fiduciary duties, but were only responding rationally to the strong negotiating position of their employees. Such bonus contracts moved part of the claims of shareholders to those in a stronger bargaining position but they are still consistent with shareholder primacy because “all of these contracts benefit shareholders in the end.”\textsuperscript{114} Yes, shareholders may have found themselves in a weak negotiating position with a board in no position to change that balance, but that does not equate to a finding that the board breached their fiduciary duties.

Fortunately, the reality of corporate law’s fiduciary duties is that they are ineffective tools in enforcing shareholder primacy\textsuperscript{115} or any presumed norm. This is true for three basic reasons. First, the business judgment rule (“BJR”) is an effective means to squash shareholder actions from an alleged breach in directors’ duty of care.\textsuperscript{116} This is the case even though the BJR has been weakened somewhat as a result of the Delaware Supreme Court’s decision in \textit{Smith v. Van Gorkom},\textsuperscript{117} the landmark case where the court established that directors could be found liable for a breach of their procedural duty of care (being informed) based on a finding of gross negligence. The BJR works primarily by precluding the courts from reviewing duty of care claims.\textsuperscript{118} It is for that reason that Professor Bainbridge has referred to the BJR as a “doctrine of abstention.”\textsuperscript{119} As stated by Professor D. Gordon Smith, “with respect to the shareholder primacy aspect of the duty of care, the deference embodied in the business judgment rule usually will be overcome only when

\begin{itemize}
\item \textsuperscript{112} Easterbrook & Fischel, \textit{supra} note 34, at 401.
\item \textsuperscript{113} Thomas A. Smith, \textit{supra} note 29, at 216–17; Macey, \textit{supra} note 32, at 1267.
\item \textsuperscript{114} Macey, \textit{supra} note 32, at 1275.
\item \textsuperscript{116} Id. at 285–86. As stated by Professor Smith, “[o]utside the takeover context, however, application of the shareholder primacy norm to publicly traded corporations is muted by the business judgment rule.” Id. at 279–80.
\item \textsuperscript{117} Smith v. Van Gorkom, 488 A.2d 858, 881 (Del. 1985).
\item \textsuperscript{118} See Henry G. Manne, \textit{Our Two Corporation Systems: Law and Economics}, 53 VA. L. REV. 259, 271 (1967) (stating that the BJR “preclude[s] the courts from any consideration of honest if inept business decisions, and that seems to be the purpose of the rule”).
\item \textsuperscript{119} Bainbridge, \textit{supra} note 94, at 87.
\end{itemize}
the actions taken by directors cannot be ‘attributed to any rational business purpose.’”  

It is also very important to note that the BJR is a presumption that directors make decisions “in the honest belief that the action taken was in the best interests of the company,” not in the best interests of shareholders. 

Second, exculpation clauses under Delaware Code Section 102(b)(7) have compounded the problem of pursuing duty of care liability claims under Van Gorkom, even if the business judgment rule has been overcome. Third, because we are dealing with a board that is presumably independent and disinterested, claims that the directors have breached their duty of loyalty as a result of conflicts of interest or self-dealing cannot be made.

This leaves “good faith,” a tool of accountability that is now subsumed under the duty of loyalty, as the only tool realistically available to the Delaware courts to enforce shareholder primacy. However, as a tool of accountability, good faith is extremely limited in its ability to support shareholder primacy. This is because the Delaware Supreme Court’s opinion in *Lyondell Chemical Co. v. Ryan,* a recent decision involving a claim that the directors breached their duty of good faith by not adequately performing their Revlon duties (duties that require a board “when it undertakes a sale of the company, to set its singular focus on seeking and attaining the highest value reasonably available to the stockholders”), applied a standard of review that makes it almost impossible to find director liability for a breach of good faith, even when it is clear that shareholder interests are of primary concern.

In *Lyondell,* the Delaware Supreme Court held that “bad faith will be found if a ‘fiduciary intentionally fails to act in the face of a known duty to

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123. *Id.* at 300 n.123.
124. *Id.* at 299–301.
125. Stone v. Ritter, 911 A.2d 362, 369–70 (Del. 2006) (“The failure to act in good faith may result in liability because the requirement to act in good faith ‘is a subsidiary element,’ i.e., a condition, ‘of the fundamental duty of loyalty.’”) (citing Guttman v. Huang, 823 A.2d 492, 506 (Del. Ch. 2003)).
Most importantly, the court required plaintiffs to demonstrate that defendants utterly failed to attempt to fulfill their Revlon duties. This standard of review will make it very difficult to hold a board liable for decisions that are not based on shareholder primacy.

In sum, corporate law does not enforce shareholder primacy through fiduciary duties, helping make sure that misperceptions regarding board and executive management decisions do not become the basis for personal liability.

V. CONCLUSION

The mystery of Wall Street’s compensation policies is solved when they are understood to be a result of the strong negotiating power possessed by traders, investment bankers, and asset managers—parties who acquired their strong negotiating position by possessing the critical assets needed by their respective firms—who did not need to make firm-specific investments and whose skills were highly valued by competing firms. Shareholder primacy may have been the corporate objective in Wall Street boardrooms, but its power to benefit shareholders was muted as shareholders possessed weak bargaining power. Therefore, Wall Street firms were not acting with a dismissive attitude toward shareholder interests when it continued to pay out large bonuses during troubled times, but simply responding rationally to the demands of those parties who possessed strong bargaining power. In essence, the hands of Wall Street boards were tied.

The strength of shareholders’ negotiating power can vary from firm-to-firm and from industry-to-industry. This has significant implications for corporate governance. Understanding the relative negotiating strength of shareholders versus non-shareholders at one’s firm is a key element of good corporate governance. Moreover, uniformly applying what shareholder activists consider good corporate governance practices can be justified where the negotiating position of shareholders is strong and where there is good cause to believe that shareholder interests are not being adequately addressed by the board and executive management. However, uniformly implementing such corporate governance practices does not change the balance of power.

129. Lyondell Chem. Co. v. Ryan, 970 A.2d at 243 (quoting In re Walt Disney Co. Derivative Litigation, 906 A.2d 27, 67 (Del. 2006)).
130. Id. at 243–44.
that exists between shareholders and non-shareholders, and if shareholders are in a weak bargaining position, the practices will not enhance shareholder value and perhaps reduce its value as there will be no compensation for the loss in efficiency that can be attributed to a reduction in board authority.

The strength of shareholders’ negotiating power also has implications for corporate law. When the bargaining power of shareholders is weak, shareholder suits claiming a breach of fiduciary duties for allegedly neglecting shareholder interests can be defended on the grounds that the board and executive management were only responding in the appropriate manner to the strong negotiating position of non-shareholders. If true, plaintiff’s claim was simply a misperception of the facts. Fortunately, corporate law does not enforce shareholder primacy through fiduciary duties, helping to make sure that such misperceptions do not become the basis for board member and executive management liability.