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# Universal Owners, Shareholder Primacy, and Stakeholderism

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# UNIVERSAL OWNERS, SHAREHOLDER PRIMACY AND STAKEHOLDERISM: HOW SHOULD UNIVERSAL OWNERS VIEW CORPORATE PURPOSE?

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ABSTRACT

*The rise of massive asset owners like large pension funds and sovereign wealth funds has created interest in the phenomenon of Universal Owners. The climate crisis, environmental degradation, and worsening inequality have also led to challenges to the current models of corporate governance, with a particular interest on the idea of corporate purpose. This paper fills a gap by addressing the intersection of these two trends, proposing a framework by which Universal Owners should view corporate purpose. I argue that from a returns-maximizing perspective, Universal Owners should prefer a flavor of shareholder primacy that believes the corporation's purpose is to contribute to sustainable economic growth. In the course of answering this question this paper also advances our understanding of Universal Owners by clarifying the difference between ESG investors and Universal Owners, and arguing for large index funds to be treated as a type of Universal Owner. This paper also contributes to the literature on heterogenous shareholder interests by identifying the potential conflict between Universal-Owners and non-Universal Owners as another example of this conflict, and one where current corporate law resolves against Universal Owners.*


TABLE OF CONTENTS

## INTRODUCTION

This paper sets out to explain how a Universal Owner should think about corporate purpose. Thus, it sits at the center of two ongoing issues in corporate governance and corporate law: The debate over shareholder primacy versus stakeholderism, and the rise of massive institutional investors as the dominant force in public markets. In Section II, I define Universal Owners, give some examples of issues they should care about, and explain who in the real-world matches the definition. The two key takeaways from this section are the distinction between the perspectives of an ESG investor and Universal Owner, and the categorization of the largest index funds as a type of Universal Owner, albeit one whose ownership is not quite as “universal” as the largest pension funds or sovereign wealth funds. In Section III, I suggest that the Universal Owner, while agreeing with the traditional shareholder primacy view on the question of to whom management should be accountable, have a unique view on corporate purpose. For the Universal Owner, the purpose of any one single firm in the economy is to contribute to sustainable, long-term growth, broadly defined. In Section IV, I address how Universal Owners may be able to implement this vision of corporate purpose. In particular I focus on a barrier that is barely addressed in the literature—that of fiduciary duties owed by management to non-Universal Owners in the firm. Thus, the overall contribution of this paper is to map out a suggested vision for corporate purpose from the Universal Owner perspective, and to flag an important barrier to implementing the Universal Owner perspective at firms.

In answering the core question, this paper also explores several corollary issues. First, it explains the difference between ESG investors'[1] (another trend that some hope will lead to a more sustainable economy) and Universal Owners' perspectives on firms' production of negative environmental externalities. Section II.C.i explains that the ESG investor's value proposition with respect to negative externalities is that these are risks which will eventually be internalized through mechanisms like reputational harm, government regulation, or changing societal norms. In contrast, for the Universal Owner negative externalities are not a risk, but an existing cost which they already (and will continue to) incur due to their ownership of the assets which directly bear the cost of externalities. Second, section II.D considers the Universal Owner concept in light of the rise of massive index funds, owned by asset managers like Blackrock. It concludes that index fund operators like Blackrock can be considered a type of Universal Owner, but they do not fit as neatly into the concept as the archetypical Universal Owners, public pension funds.

Section III answers the core question of the paper. It concludes that what the Universal Owner should prefer is a type of shareholder primacy, which I refer to as "Sustainable Growth Primacy." In their ideal model of corporate purpose, corporate managers and directors would remain solely accountable to shareholders, but they would manage the firm not to maximize profits as such, but to contribute to long-term sustainable growth across the Universal Owner's portfolio, i.e., the economy. In other words, the purpose of firms for Universal Owners is to contribute to the maximization of the Universal Owner's portfolio. Certainly, all investors want firms to contribute to portfolio maximization. But the non-Universal Owner either can avoid firm-produce externalities in part or entirely, and so in practice "maximizing portfolio value" almost always means "maximize firm value." In contrast, because the Universal Owner cannot escape externalities, maximizing portfolio value does not always entail maximizing firm value.

Finally, Section IV examines the problem of heterogenous shareholder interests in the context of Universal Owners and Sustainable Growth Primacy. This issue is one that the Universal Owner literature has in large part ignored. Corporate governance literature and courts have tried to deal with the problems engendered by conflicts between shareholders over the future direction of the firm, such as in the case of preferred versus common stockholders. Because

[1] Universal Owners could also be considered "ESG investors" insofar as they also care about ESG issues. But when this paper refers to "ESG investors" it is referring to non-Universal Owner investors who take ESG issues into account in valuing firms.

directors and managers owe fiduciary duties to the firm (and not directly to shareholders) directors are essentially obligated to resolve conflicts in favor of the shareholders whose interests are most coextensive with the firm's. Regardless of the resolution of the dispute, in an efficient market one would expect all shareholders' expectation about the short- and long-term of the firm to be reflected in the stock price. Section IV examines how the Universal Owner's ability to implement their vision of corporate purpose at individual firms will be stymied by the current structure of fiduciary duties. Additionally, "efficient markets" is not a suitable consolation price for Universal Owners because even a perfectly efficient market may not incorporate unpriced externalities, as by definition, they do not harm firm value. It concludes by proposing several solutions for Universal Owners, including focusing on policy changes at the governmental level and adopting greater use of alternative corporate forms like the Delaware Public Benefit Corporation. Counterintuitively, alternative corporate forms' alteration of fiduciary duties to allow management to balance profitability with other concerns can actually be in the interest of Universal Owners as it allows managers to adopt the same broad perspective as Universal Owners.

Thus, the paper contributes to the literature around Universal Owners by suggesting a viewpoint on corporate purpose for Universal Owners and flagging an important barrier to the implementation of Universal Owner concepts. It also contributes to corporate governance literature generally, by pointing out the conflict between Universal Owners and other shareholders at firms is an extreme example of the conflict between heterogenous shareholder interests.

The paper proceeds as follows. Section II defines the Universal Owner, including tracing a brief history of the concept, and explains what makes Universal Owners unique as well as who should be considered a Universal Owner. Section III argues that Universal Owners' view on corporate purpose should be a unique flavor of shareholder primacy. Section IV discusses implementation issues as well as argues that the framework of Sustainable Growth Primacy can help explain certain actions taken by Universal Owners.

Two caveats are worth raising at the start of the paper. First, when the "interests" of Universal Owners are discussed, it is solely within the context of maximizing portfolio returns. There may be characteristics of Universal Owners that create other interests. For example, as representatives of workers, pension funds may legitimately view the protection of worker rights as an "interest" of theirs, while the national security of the state that owns a sovereign wealth fund may be a legitimate interest as well for that fund. This may all be true, but this paper analyzes Universal Owners in their capacity as investors, and as such defines interest in that manner. Second, the analysis is intended to be agnostic as to whether the existence of Universal Owners is good for society, and whether it would be socially optimal if Universal Owners were able to imprint their vision of corporate purpose on firms. Regardless of personal views, the paper is intended to answer the question: What vision of corporate purpose would be in the best interests of Universal Owners? Whether or not it would be in the best interests of society is an entirely separate question.

## I. WHAT IS A UNIVERSAL OWNER?

### *A. Definition*

The Universal Owner is an asset owner that is sufficiently diversified and large that it essentially owns a slice of the entire national (or global) economy. While there is a diversity of formulations of the concept, to be a Universal Owner, the core features of the definition are that your holdings must both be 1) vast and 2) diversified, and 3) your investment perspective must be long-term.[2] These features are important, because the combination of them are necessary to make the Universal Owner's portfolio a representative slice of the economy. The global economy consists of many firms, across many industries, and will exist for the indefinite future, barring a complete collapse of civilization. Diversification ensures the Universal Owner is not concentrated in a few companies or a few industries, vastness ensures the Universal Owner will own a non-de minimis stake in many companies within every industry, and long-term orientation ensures that the Universal Owner also owns a piece of the future economy. Owning a representative slice of the global economy in turn means that Universal Owners essentially own the externalities of their portfolio firms, and the performance of their portfolios depends upon the performance of the economy as a whole. Definitions of the concept have varied in their language

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2 *See* James Hawley and Andrew Williams, *The Emergence of Universal Owners: Some Implications of Institutional Equity Ownership*, 43 CHALLENGE 43, 45 (2000) ("the quintessential universal are the largest of the public and private pension funds because they have amassed investment portfolios that naturally comprise a broad cross section of the financial assets available for investment, and their objective - to provide pensions - naturally gives them a long- term perspective toward wealth maximization." Emphasis added); PWC, THE SDG INVESTMENT CASE 16 (2017) ("Large institutional investors relying on modern portfolio theory can be considered "universal owners": their highly-diversified, long-term portfolios are sufficiently representative of global capital markets that they effectively hold a slice of the overall market, making their investment returns dependent on the continuing good health of the overall economy." Emphasis Added); TRUCOST, WHY ENVIRONMENTAL EXTERNALITIES MATTER TO INSTITUTIONAL INVESTORS 3 (2010) ("Large institutional investors are, in effect, "Universal Owners", as they often have highly-diversified and long-term portfolios that are representative of global capital markets." Emphasis Added)

and focus. Some highlight the connection between portfolio performance and economic growth:

> The fundamental characteristic of a universal owner is that it cares not only about the governance and performance of the individual companies that compose its investment portfolio, but that it also cares about the performance of the economy as a whole… it "owns" the economy (typically, a highly representative sample of the economy) and, therefore, bears the costs of any shortfall in economic efficiency and reaps the rewards of any improvement.[3]

Other definitions highlight the ownership of externalities as the most important characteristic to focus on. Quigley's 2019 literature review concludes that most definitions have focused on "the concept of a portfolio so large and diversified that it is difficult or impossible to sell out of externality-producing firms; the costs of firm specific externalities are borne across the remainder of the holdings."[4] There is little substantive disagreement between the two lines of definitions. Definitions that discuss global economic growth also emphasize that the production of negative externalities is the mechanism by which the Universal Owner's portfolio is harmed.[5] Definitions that emphasize ownership of externalities also suggest that returns are dependent upon general macroeconomic performance.[6] Yet there are two important takeaways from comparing the two definitions.

First, emphasizing the connection between overall economic performance and returns opens up a broader landscape of issues that Universal Owners should be concerned with it. In the Universal Ownership context, ownership of externalities is often conceived of as primarily bearing the cost of negative externalities.[7] But positive externalities exist as well—education and industrial research and development have positive spillover effects on economic growth beyond their benefits to the firm.[8] Emphasizing the connection between

[3] Hawley and Williams, *supra* note 2, at 45; *see also* PWC, *supra* note 2, at 16.

[4] Ellen Quigley, *Universal Ownership in the Anthropocene*, SSRN ELECTRONIC J., 4 (2019); *see also* Raj Thamotheram and Helen Wildsmith, *Increasing Long-Term Market Returns: realising the potential of collective pension fund action*, 15 CORP. GOVERNANCE AN INT'L REV. 438, 438 (2007) ("The UO hypothesis states that although a large long-term investor with a diverse investment portfolio can initially benefit from an investee company externalising costs, the investor might ultimately experience a reduction in market and portfolio returns due to these externalities adversely affecting returns from other assets")

[5] PWC, *supra* note 2, at 16.

[6] CONFERENCE REPORT, UNIVERSAL OWNERSHIP: EXPLORING OPPORTUNITIES AND CHALLENGES 6 (2006)

[7] Quigley, *supra* note 4 at 4 ("the costs of firm specific externalities are borne across the remainder of holdings")

[8] Margaret Stevens, *A Theoretical Model of On-the-Job Training with Imperfect Competition*, 46 OXFORD ECON. PAPERS 537, (1994) (discussing worker training); Bronwyn Hall, Jacques Mairesse, Pierre Mohnen,

economic growth and returns shows that increasing these positive externalities could be a goal of Universal Owners. Additionally, there are harms to economic growth and economic performance that are not typically conceived of as externalities. For example, monopolistic pricing is generally viewed as welfare reducing, and thus harmful to economic performance,[9] but it is not really an externality. If the Universal Owner should primarily focus on economic growth, then they would have reasons to oppose monopolistic behavior by portfolio companies.

Second, the emphasis on economic performance and returns seems to ignore the plausible possibility that there exist policies and mechanisms that increase economic growth (thus increasing returns to Universal Owners in the first instance) by decreasing the share of national income to capital (and increasing it to labor) by such an extent as to wipe out the Universal Owner's gains from the increased growth. For example, suppose a national government had a policy of buying private firms and turning them into worker cooperatives. If the worker cooperatives were more productive than the previous method of ownership, then the effect on economic growth could be positive. Yet if the Universal Owner lost portfolio companies to this policy, it is plausible that they would see a decrease in overall returns. Less extreme versions of this scenario could be increases in minimum wage or increases in unionization levels. It is probably true (to an extent) that—as some have argued—improving the status of labor and supporting a strong middle class is beneficial to Universal Owners because it increases economic growth, and the Universal Owner can reap those benefits.[10] However, it seems probable that this win-win dynamic will not be universally true for all possible policies and forms of economic organization. Moreover, policies that do not improve economic growth, but increase the share of national income to capital, would seem to be desirable from the Universal Owner perspective.

Taking these insights altogether, my definition of the Universal Owner for this paper will be that a Universal Owner is an investor who, because of their size, diversification, and long-term investment horizon, cannot escape the spillover effects (both positive and negative) of portfolio company behavior, and

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*Measuring the Returns to R&D*, *in* HANDBOOK OF THE ECONOMICS OF INNOVATION 1033 (research and development)

9 *Deadweight Loss*, CORPORATE FINANCE INSTITUTE, https://corporatefinanceinstitute.com/resources/knowledge/economics/deadweight-loss/ (last accessed May 24, 2021)

10 *See* OECD, UNDER PRESSURE: THE SQUEEZED MIDDLE CLASS 17-18 (2019) (summarizing the productivity and growth benefits of a strong middle class)

as such as an interest in minimizing the negative spillover effects and maximizing the positive spillover effects. Spillover effects are essentially externalities, and I will use the terms fairly interchangeably in the paper, but it useful to explicitly flag that I am conceiving of externalities in the broadest possible manner.

### *B. History of the Concept*

The concept of the Universal Owner is usually credited to Robert A.G. Monks and Nell Minow's 1995 textbook on corporate governance.[11] Though the textbook does not use the specific phrase "universal owner", in its section on pension funds it describes them in terms clearly foreshadowing the universal owner concept:

> pensions are becoming indexed equity holdings. This makes them both universal and permanent shareholders. Their holdings are so diversified that they have the incentive to represent the ownership sector (and the economy) generally rather than any specific industries or companies. This endows them with a breadth of concern that naturally aligns with the public interest.[12]

Hawley and Williams in 2000 appear to be the first to explicitly use the term "universal owners" to describe this phenomenon.[13] One point worth noting about this early development, and the subsequent development in the 2000s, is that it came out of the corporate governance literature, from writers focused on pension funds. Monks and Minow introduced the concept in their book on corporate governance. In 2007, the journal "Corporate Governance, An International Review" had a special edition on Universal Owners.[14] Given that a 2019 literature review only found seventeen articles whose primary focus was Universal Ownership,[15] the seven articles in that special edition comprise a significant proportion of the scholarship directly focused on the concept. Hawley and Williams (responsible for five of the seventeen articles mentioned)[16] as well as Monks, are also scholars of "fiduciary capitalism." Fiduciary capitalism refers

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[11] *See* CONFERENCE REPORT, *supra* note 6, at 6; PWC, *supra* note 2, at 16 (footnote 14).

[12] ROBERT A.G. MONKS AND NELL MINOW, CORPORATE GOVERNANCE 132 (1st ed. 1995). Note that the exact language is repeated in the most recent edition of the book. ROBERT A.G. MONKS AND NELL MINOW, CORPORATE GOVERNANCE 167 (5th ed. 2011)

[13] *See* Hawley and Williams, *supra* note 2, at 44 ("Following Robert Monks and Nell Minow, corporate governance activists and authors of Corporate Governance and the principals of Lens Inc., we argue that many of these large fiduciary institutions are "universal owners.")

[14] 15 CORP. GOVERNANCE AN INT'L REV. 415, 415-497 (2007)

[15] Quigley, *supra* note 4 at 3

[16] Quigley, *supra* note 4 at 3 (footnote 1)

to the rise of institutional investors, who are investing on behalf of underlying beneficiaries,[17] as the dominant model of ownership in public markets.[18] Pension funds are the preeminent example of these investors, along with mutual funds and university endowments.[19]

Following this definition, the concept was further developed in both academic and non-academic literature in the 2000s.[20] Quigley's 2019 literature review contains a good summary of the variety of critiques of Universal Owner theory.[21] While most critiques accept a basic version of Universal Owner theory—that sufficiently large asset owners bear externalized costs—they tend to focus on either the desirability of acting upon these insights or the practical ability of Universal Owners to actually implement the insights. On the former, some have raised concerns that Universal Owner theory will be used to smuggle in political goals that are disconnected from financial goals.[22] On the latter, Universal Owners do not always seem to behave in the way they should,[23] and I think this set of barriers address the issue of why. The two barriers that seem most on point are institutional barriers like the short-term incentives facing fund managers, and the lack of actionable data to support specific actions. While Universal Owners may have ultra-long-term interests, a pension fund does not make decisions—the managers of pension funds make decisions. For the fund manager, they may view discount future returns because they believe they are being judged on short-term targets and performance.[24] Many public pension

[17] Hawley and Williams, *supra* note 2, at 44 ("The beneficial claims on the assets of these fiduciary institutions are a form of indirect or mediated ownership because they represent claims to payments rather than alienable claims to the equity or debt instrument itself. Similarly, mutual funds represent merely a claim on residual gains (or losses), not on the actual stock certificate itself.")

[18] Robert A.G. Monks, *Two Challenges for Fiduciary Capitalism*, 15 CORP. GOVERNANCE AN INT'L REV. 486, 486 (2007)

[19] *See id.* at 487

[20] Robert Urwin, *Pension Funds as Universal Owners: Opportunity Beckons and Leadership Calls*, 4 ROTMAN INT'L J. OF PENSION MGMT. 26, 27 (2011)

[21] Quigley, *supra* note 4, at 5-8

[22] Ola Peter Krohn Gjessing and Henrik Syse, *Norwegian Petroleum Wealth and Universal Ownership*, 15 CORP. GOVERNANCE AN INT'L REV. 427, 434 (2007)

[23] *See* Quigley, *supra* note 3, at 7 ("Further critiques of Universal Ownership Theory include the charge that large institutional investors do not appear to behave like Universal Owners (Richardson, 2015; Richardson and Peihani, 2015). Indeed, a survey of hundreds of European investors found that only 3% of them are yet compliant with the EU Shareholder Rights Directive II, a set of corporate governance requirements that are very much in line with Universal Ownership (Hermes EOS, 2019). Hawley (2011) suggests that Universal Owners contributed to the 2008 financial crisis by failing to perform the basic corporate governance and risk analysis functions that their nature as Universal Owners arguably demanded")

[24] Urwin, *supra* note 20, at 27; *see also* Monks, *supra* note 18 (arguing that the promise of fiduciary capitalism will never be fulfilled unless institutions actually participate as owners in companies, fulfill their fiduciary duties, and fund managers stop outsourcing their duties to consultants who add little value)

funds are underfunded relative to liabilities,[25] and so there is naturally going to be pressure to attempt to make up the gap in the short term and let the next generation of managers worry about future performance. Another form of institutional barriers is the fact that many large asset owners like pension funds rely on advisers and consultants for investment decisions, and often invest through asset managers that have less of a long-term orientation.[26] They do this in part because the trustees believe relying on "experts" will protect them from litigation risks from their own beneficiaries.[27] Finally, it may be easy to say generally that negative externalities hurt portfolio performance, but it is not easy to quantify these costs. As one source puts it "asset owners have found the financial case hard to express and validate."[28] For example, even the largest, most diversified asset owner on Earth likely will not bear a proportional slice of the externalities caused by climate change—given that there are areas of the world that are fairly disconnected from the global economy.[29]

### C. *Externalities and Portfolio Returns*

As discussed above, what makes a Universal Owner unique relative to the traditional conception of a shareholder is their relationship to portfolio companies' externalities. The traditional story for externalities implicitly assumes that if the firm benefits from the externality, its owners must as well (financially at least). The train is driving along the railway; the soot it produces damages the clothes drying at a neighboring laundromat; forcing the laundromat to cut its output because it can only dry clothes when trains are not running. In this simple story, we may assume that the train owner benefits from imposing this cost on the laundromat. This is certainly true where the firm owner's only financial asset is their share in the firm producing the externality. In that scenario, the owner would be able to avoid 100% of the externalized costs. The same logic is true for owners that have interests in multiple corporations and other asset classes, especially if they actively manage their ownership stakes. In such a scenario, the odds of me holding the asset that bears the externalized costs

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25 *See* Dan Walters, *California's immense pension dilemma*, CALMATTERS (Aug. 10, 2020) https://calmatters.org/commentary/dan-walters/2020/08/california-court-pension-debt-unfunded/ (reporting that CalPERS is only 70.8% funded based "based on an assumption of future investment earnings averaging 7% a year, which probably is at least one or two percentage points too high.")

26 Matthew Kieran, *Universal Owners and ESG: Leaving Money on the Table?*, 15 CORP. GOVERNANCE AN INT'L REV. 478, 482-83 (2007)

27 Monks, *supra* note 18, at 491

28 Urwin, *supra* note 20, at 27

29 *See* Gjessing and Syse, *supra* note 22, at 432 ("pollution that reduces agricultural output in a poor, remote and self-sufficient community raises ethical and possibly political issues, but may not hit the typical institutional rich-world investor financially")

of another portfolio company's behavior are fairly low. Even if I could not divest myself of the proverbial laundromat, it is unlikely that I am bearing the full cost of the externality if I do not own any of the other three laundromats along the railroad. But because the universal owner essentially owns a representative slice of the economy, it cannot escape its portfolio companies' externalities. One way or another, it will pay the bill. Returning to the analogy of the laundromat once more, the Universal Owner will own both a small piece of the railroad, as well as a small piece of every business directly adjacent to the railroad, as well as a small piece of every creditor and supplier of each of those businesses.

To put it in mathematical terms, if the Universal Owner owns 1% of every company in the economy, then it would get 1% of the benefit of externalizing the cost (i.e., 1% of the increased profits of the railroad) as well as 1% of the present and future externalized costs (i.e., 1% of the lost profits to the companies bearing the cost). Because they own a representative slice of the economy, they will own an equal share of the of the benefit and an equal share of the cost, and so they should compare the overall cost to the overall benefit. Thus, whether the Universal Owner benefits from the externality depends on whether the net present value ("NPV") of the firm-specific benefits is greater than the NPV of the portfolio wide losses. It should be clear that the benefit here is not the profits from the externality-causing activity, but the money saved by not internalizing the externality. These numbers will be different when there are actions that a firm can take to internalize externalities without ceasing the activity entirely. For example, if the railroad could install scrubbers to reduce soot, or use a different form of coal that produced less soot. Thus, it is the Universal Owner's interest to compare the cheapest method of reducing the externalized costs to the actual reduction in externalized costs.

There is an important qualification to this story. This is the fact that if a firm's overall value to the Universal Owner is negative (i.e., the externalized costs exceed profits) it might lead to the conclusion that the firm should simply stop operating, if it cannot find a cheaper way to reduce the externality. However, this ignores the fact that the Universal Owner will also own businesses that rely on that firm. Whether they are suppliers to the firm, creditors, or customers—their earnings will be harmed if the firm simply closes up shop and stops doing business. The railroad may be a crucial piece of infrastructure, and other businesses owned by the Universal Owner may rely on it for transporting goods. This example illustrates that even in the case of negative externalities, the firm can still also have positive effects that are not captured in its annual profits. Thus, unless the goods and services provided by the firm are perfectly substitutable from other sources, it is likely that the Universal Owner would generally always prefer that firms stay in business while internalizing externalized costs. As a side note, all of these nuances exemplify why the critique discussed in section II.B as to the lack of actionable data rings true: Even if we know the Universal Owner bears some portion of the externalized cost, it is not always clear what that portion is or what would be the consequences of internalizing the cost.

One crucial aspect of this theory is that it is fundamentally different from the argument that producing externalities hurts a firm's financial well-being, i.e., the argument made by ESG investors.[30] ESG investors might argue that externalizing costs harms the company itself, because of reputational harm[31] or because eventually regulatory action will force the company to externalize the cost.[32] Thus, an ESG investor might change their valuation of the railroad company because they believe eventually regulators will force the company to internalize the cost through mandates, or that the company may be liable in court for damages to the laundromat. To use a real-world example, part of the value proposition behind climate-related ESG investing is that eventually a carbon tax or other form of climate policy will be implemented, forcing fossil fuel and other carbon-intensive companies to internalize the cost of emissions, which in turn will reduce their ability to provide value for shareholders. While the Universal Owner may also be concerned with such a prospect, they are fundamentally different from the ESG in that they already (and will continue to) bear the costs of the externality through its effect on other portfolio companies. In other words, what the ESG investor identifies as risks to the firm (environmental and social externalities), are simply already existing costs to Universal Owner. Thus, the "standard" investor, the ESG investor, and the Universal Owner all have different perspectives on whether a firm should engage in any course of action where they will generate externalities, again broadly defined to include positive externalities and other actions with negative effects on economic growth like monopolistic price-setting:

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30 *See, e.g.*, Charles Wallace, *When "Externalities" Aren't External: Poor ESG Exposure Leads to Increased Risk*, IMPACTIVATE (Dec. 21, 2017) https://www.theimpactivate.com/when-externalities-arent-external-poor-esg-exposure-leads-to-increased-risk/

31 *See* FactSet Insight, *Corporate Governance, Reputational Risk, and why ESG Matters*, FACTSET (Jan. 2, 2020) https://insight.factset.com/corporate-governance-reputational-risk-and-why-esg-matters-key-takeaways

32 *See* Simon Thomas, Robert Repetto, and Daniel Dias, *Integrated Environmental and Financial Performance Metrics for Investment Analysis and Portfolio Management*, 15 CORP. GOVERNANCE AN INT'L REV. 421, 422 (2007) ("Mainstream investors also must have an interest in external environmental costs because environmental laws, regulations and emissions trading schemes increasingly act to internalise these costs for companies")

| | Firms should engage in an action when… |
|---|---|
| Standard investor | The NPV of cash flows generated is positive |
| ESG Investor | The NPV of cash flows generated is positive, adjusted by the expected value of externality internalization (risk of forcible internalization * magnitude of effect of internalization) |
| Universal Owner | The NPV of cash flows generated is positive, adjusted for the externalities produced by action. |

As discussed in section II.A, the effect of externalities on portfolio returns can be conceptualized as either a direct effect on portfolio company performance[33] or as a process where externalities affect economic growth, and the reduction (or increase) in economic growth in turn affects the long-term total returns of stock indices, which are closely correlated with Universal owner performance.[34] Long-term returns from the stock market are the most important influence on Universal Owner performance.[35] The total return from the stock market is driven by three components: Dividend yields, growth in profits and changes in valuation.[36] Growth in profits is the most important component, and the growth rate of profits "is primarily a function of overall economic expansion."[37]

Regardless of the mechanism, one of the main critiques of Universal Owner theory is the difficulty operationalizing these insights. It may be accurate on a general level, but that does not provide actionable insights for Universal Owners. Discussing the lack of universal owner pressure on tobacco companies in the 1990s, one paper reported that they were aware of the significant negative

33 TRUCOST, *supra* note 2, at 8; CONFERENCE REPORT, *supra* note 6, at 4

34 Steve Lippman, Daniel Rosan, and Adam Seitchik, *Why Lower Drug Prices Benefit Institutional Investors: an application of universal ownership theory*, 15 CORP. GOVERNANCE AN INT'L REV. 455, 459 (2007); Thamotheram and Helen Wildsmith, *supra* note 4, at 437-38 (identifying three sources of long-term market returns that in turn raise equilibrium growth rates and return on capital)

35 *Id.*; *see also* Gjessing and Syse, *supra* note 22, at 429 ("The idea that large institutional investors such as Norway's Government Pension Fund – Global (managed by NBIM) can be characterised as universal owners is now well established. The fund's principal has set global benchmarks for both equity and fixed income, and a maximum tracking error of 1.5 per cent. This means that the absolute return of the fund is strongly influenced by the performance of the global equity market. For this reason, the fund's long-term financial interest lies with the ability of the global markets to produce sustainable economic growth, and with the functionality of the equity market")

36 *Id.*

37 *Id.*

externalities caused by smoking but "it was felt that there was a lack of hard data equivalent to financial data, which might justify stronger action."[38] To address this issue, some researchers have attempted to quantify the effect of potential externalities. From examining some of this work, climate change appears to be the externality where researchers have had the most success in generating detailed, granular, asset level data on the risks posed by it.

### 1. *Environmental Externalities*

A 2010 analysis by Trucost constructed a hypothetical $10 billion fund invested in the MSCI All World Country Index, comprised of 2,439 companies across developed and developing economies.[39] They then looked at the impact of five different environmental externalities upon the global economy and the hypothetical fund (greenhouse gas emissions, water overuse, air pollution, waste, and natural resource overuse).[40] They hypothetical investor would be proportionally responsible for $560 million of externalities caused by those listed companies annually.[41] The cost of the externalities equaled over 50% of portfolio companies' earnings.[42] Globally, environmental externality costs were an estimated $6.6 trillion, equivalent to 11% of the global economy at the time.[43] The top 3,000 companies by market capitalization generated $2.15 trillion of those externalities.[44] Not only would Universal Owners benefit from reducing production of environmental externalities because of the direct reduction in costs, the Porter Hypothesis suggests that when firms are forced to internalize costs, the incentives given to them generates a search for "new, superior methods of production", making firms more profitable in the long-run.[45]

### 2. *Climate Change*

Climate change is an environmental externality. In the 2010 Trucost study, emissions of greenhouse gases were responsible for the lion's share of externalized costs, $4.5 trillion of the $6.6 trillion.[46] There is a growing body of research and industry efforts to quantify climate risk at the asset level, such as the services provided by the Rhodium Group to analyze risks to individual assets

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38 Hawley and Williams, *supra* note 2, at 52
39 TRUCOST, *supra* note 1 at 8
40 *Id.* at 4
41 *Id.* at 8
42 *Id.*
43 *Id.* at 4
44 *Id.* at 6
45 Thomas et al., *supra* note 32, at 422
46 *Id.* at 4

and portfolios[47] and the work of the Climate Impact Lab to produce community level risk assessments.[48] The risks to Universal Owners from climate change are not limited to physical risks. As the prospect of significant long-term climate damages becomes more apparent to investors, the risk of more immediate portfolio losses increases as markets shift, with reductions in portfolio value of up to 45%.[49] Because Universal Owners can only hedge against losses to a limited extent, the only way to prevent significant losses is to reduce the externality. Finally, even though the losses are stark even at 2 or 3 degrees, there is a small but non-zero probability of runaway climate change in the 6-to-7-degree range, at which point the complete collapse of the human civilization as we know it is a realistic possibility.[50] One could conservatively estimate the portfolio losses in that scenario to be roughly 100%.

### *3. Drug Pricing*

Demonstrating the effect of high prescription drug costs on Universal Owners is a useful exercise, because it could show how Universal Owners could be affected by more than just the traditional environmental externality. As a 2007 study by Lippman et al., argued, drug pricing is the United States exhibits feature of monopolistic pricing.[51] Since markets with monopolistic pricing exhibit deadweight loss, cutting drug prices should (in theory) increase total welfare.[52] The study modeled the effect on welfare and concluded significant cuts in drug prices would be beneficial to the Universal Owner.[53] Since the Universal Owner also owns the insurance companies that pay for drug prices, they would share in the increase in consumer surplus.[54] The government is also a purchaser of drugs, and the cost savings from reduced drug pricing could accrue to the Universal Owner through increased levels of consumption, or government spending in other areas.[55] Finally, if lower prices expand access to drugs, the Universal Owner would benefit from the healthier, more productive

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47 *Climate Risk Service*, RHODIUM GROUP, https://rhg.com/data_story/climate-risk-service/ (last accessed May 19, 2021)

48 *Our Approach*, CLIMATE IMPACT LAB, https://www.impactlab.org/our-approach/ (last accessed May 19, 2021)

49 UNHEDGEABLE RISK: HOW CLIMATE CHANGE SENTIMENT IMPACTS INVESTMENT, CISL 29 (2015)

50 Quigley, *supra* note 4 at 12; *see also* Will Stefen et al., *Trajectories of the Earth System in the Anthropocene*, 115 PNAS (2018)

51 Lippman, Rosan, and Seitchik, *supra* note 34 at 457

52 *Id.* at 461

53 *Id.* at 455

54 *Id.* at 461

55 *Id.*

labor force in its other industries.[56] While the socially optimal price of prescription drugs may be debatable, this exercise is useful because it implies that Universal Owners should oppose monopolies and oligopolies in industries. The benefits they gain from the monopoly's increased profits are offset by the deadweight loss, which shows up as increased costs or foregone opportunities for its other companies. One very pertinent current example in the pharmaceutical world is the vaccine for Covid-19. There is an obvious financial interest for Universal Owners in vaccinating the world as rapidly as possibly—even if it cuts into the profits of Pfizer or Moderna, the benefits to other portfolio companies (such as airlines) are much bigger. In practice, we have seen large institutional investors like Blackrock urge pharmaceutical companies to collaborate, not compete, to develop and produce the vaccine.[57]

### *4. Research and Development*

Corporate research and development are examples of positive externalities—the firm benefits from the research but there can be positive spillover effects into other firms in the industry or even other industries. A 2010 meta-analysis found that although rates of return on R&D were substantial, studies have consistently shown that the social return was even greater due to positive spillover effects.[58] Given that these spillover effects are often realized by firms in other industries, the Universal Owner realizes a greater benefit from firm R&D than a normal owner of the firm. This same basic dynamic is possibly present in other situations where a firm-level investment produces public goods, such as infrastructure and employee training.

## II. WHO ARE THE UNIVERSAL OWNERS?

Now that we have a basic definition of the concept, and an understanding of the unique perspectives they have on the firm, and firm activities, the final relevant question is "who in the real world actually meets this definition?" The literature views large public pension funds as the preeminent example of universal owners.[59] The largest asset owner in the world is the Japanese government pension fund (GPIF) (with $1.6 trillion in assets).[60] Eleven of the

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[56] *Id.* at 462

[57] Matt Levine, *Investors want a cure, not a winner*; BLOOMBERG (Apr. 24, 2020) https://www.bloomberg.com/opinion/articles/2020-04-24/investors-want-a-cure-not-a-winner; Matt Levine, *Index funds will save us*, BLOOMBERG, (February 24, 2021)

[58] Hall et al., *supra* note 7, at 1073 (see table 5 on page 1060 for a table containing results)

[59] *See* Hawley and Williams, *supra* note 2, at 45; MONKS AND MINOW, *supra* note 12, at 132

[60] THE THINKING AHEAD INSTITUTE, THE THINKING AHEAD INSTITUTE'S ASSET OWNER 100:

largest twenty-five asset owners are pension funds, with largest U.S. fund being the half a trillion dollar Federal Retirement Thrift, followed by CalPERS with a mere $374 billion in assets.[61] Not only do these funds have the size to be a universal owner, they also have the diversification to do. Aside from the dictates of modern portfolio theory suggesting it is wise to do so,[62] in the United States, at least some private pension funds are legally required to offer diversified holdings to employee beneficiaries.[63] Thus, they have both the resources and the desire to own a small slice of the vast majority of publicly traded companies, as well indirect interests in private companies through stakes in private funds.[64] Finally, and most unique to pension funds, is their ultra-long term orientation. Pension funds owe a fiduciary duty to all beneficiaries, including younger current employees of the relevant firm/government.[65] Thus, CalPERs has an equal duty to maximize returns for an employee of the state of California who is twenty-five years old as they do for current pension fund beneficiaries. In the law then, pension funds are required to not mortgage the future for higher returns in the present.

The next group of investors who may make sense as Universal Owners are other large asset owners, most notably sovereign wealth funds (SWFs). The Norwegian SWF is the second largest asset owner in the world, with just over $1 trillion in assets.[66] There are five other such funds in the top ten of asset owners representing China, the United Arab Emirates, Kuwait, Hong Kong, and Saudi Arabia.[67] While the Norwegian SWF does not appear to self-identify with

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THE MOST INFLUENTIAL CAPITAL ON THE PLANET 34 (2021)

[61] *Id.*

[62] *See* PWC, *supra* note 2, at 16 for the proposition that large institutional investors rely on modern portfolio theory. For a brief explanation of modern portfolio theory, *see Modern Portfolio Theory (MPT)*, Corporate Finance Institute, May 19, 2021, https://corporatefinanceinstitute.com/resources/knowledge/trading-investing/modern-portfolio-theory-mpt/.

[63] *See* ROBERT A.G. MONKS AND NELL MINOW, CORPORATE GOVERNANCE 155 (5th ed. 2011) ("the sole substantive requirement of [ERISA] is diversification.].

[64] PEW CHARITABLE TRUSTS, STATE PUBLIC PENSION FUNDS' INVESTMENT PRACTICES AND PERFORMANCE: 2016 DATA UPDATE 1 (2016) (pension funds investing into private equity); *Investment*, NASRA, https://www.nasra.org/investment (last accessed May 24, 2021) (reporting that 47% of public pension fund assets are in public equities, 7.4% in real estate, and 19.4% in alternative investments);

[65] B.J. Richardson and Maziar Peihani, *Universal Investors and Socially Responsible Finance: A Critique of a Premature Theory*, 30 BANKING AND FIN. L. REV. 405, 450 (2015).

[66] THE THINKING AHEAD INSTITUTE, *supra* note 60, at 34. Note that the source labels the Norwegian Fund a pension fund, probably in part because "pension" is in its name. But it is clearly a sovereign wealth fund—it is not a retirement fund to support a set group of beneficiaries, but a nationally owned asset managed by the Norwegian Central Bank and funded by oil revenues as a way to create sustainable wealth instead of being dependent upon fluctuations in the oil market. For a further description of the fund, see Gjessing and Syse, *supra* note 22

[67] THE THINKING AHEAD INSTITUTE, *supra* note 60, at 34.

the term "Universal Owner", a 2007 article by two employees of Norges Bank (the manager of the fund) used Universal Owner theory to analyze the fund's operations,[68] and the fund's logic for its focus on "responsible investment" (i.e. focuses on sustainability and corporate governance) could be pulled out of any essay on Universal Owners.[69] Acting as a universal owner makes sense for the Norwegian SWF, because it owns 1.5% of all publicly traded equities in the world.[70]

Aside from their size and diversification, large SWFs also have a long-term time horizon. While the concept of equal fiduciary duty to present and future beneficiaries is not necessarily present for SWFs, they are intended to be long-term portfolios that provide a stable source of revenue for the country. It is not a coincidence that four out of the six largest SWFs are from countries with significant petroleum exports. As explained by Norges Bank, "The fund was set up to shield the economy from ups and downs in oil revenue. It also serves as a financial reserve and as a long-term savings plan so that both current and future generations get to benefit from our oil wealth."[71] Thus, the same concern for a stable, sustainable, long-term economy is present for SWFs.

The final group of investors who could be considered as Universal Owners are the large index fund providers, particularly the Big Three: Vanguard, Blackrock, and State Street.[72] The literature is split on whether asset managers like these institutions are universal owners.[73] More than explicitly considering and rejecting index fund providers as universal owners, the universal owner literature often focuses entirely on pension funds and a few other asset owners.[74] There are two dimensions where index funds may fail to meet the criteria to be

[68] Gjessing and Syse, *supra* note 22.

[69] *The Purpose of Responsible Investment*, NORGES BANK INVESTMENT MANAGEMENT https://www.nbim.no/en/the-fund/responsible-investment/responsible-investment/ (last accessed May 19, 2021) (explaining that it focuses on responsible investment because it invests for the long-term, globally, and widely).

[70] *About the fund*, NORGES BANK INVESTMENT MANAGEMENT https://www.nbim.no/en/the-fund/about-the-fund/ (last accessed May 19, 2021).

[71] *Id.*

[72] Scott Hirst & Lucian Bebchuk, *The Specter of the Giant Three*, 99 B.U. L. REV. 721, 723 (2019)

[73] *Compare* Thamotheram and Helen Wildsmith, *supra* note 4, at 440 (arguing that public pension funds were well-suited for the Universal Owners thesis because "In comparison with corporate pension funds, major insurance companies and large fund management firms, public pension funds are, in general, much less likely to have conflicts of interest vis-à-vis their corporate sponsors or corporate clients when trying to influence corporate behaviour") *with* Quigley, *supra* note 4 at 2 ("Entities typically recognised as Universal Owners include large institutional investors such as pension funds, sovereign wealth funds, mutual funds, insurance companies, foundations, and endowments.")

[74] *But see*, Roberto Tallarita, *Portfolio Primacy and Climate Change*, SSRN (2021) for a critique of the idea that index funds' commitment to "portfolio primacy" creates the incentives needed for such investors to be a powerful tool in the fight against climate change.

considered a Universal Owner. The largest index mutual funds seem have the size to meet that dimension of Universal Ownership. In terms of assets under management, the Big Three dwarf the largest asset owners: Blackrock with \$8.68 trillion,[75] Vanguard with \$7.2 trillion,[76] and State Street with a mere \$3.5 trillion.[77] Add in the fact that the point of an index fund is to provide broad exposure to capital markets, and you have a public market where (as of 2017) the combined Big Three are the largest shareholder in 88% of the companies in the S&P 500.[78] However, this enormous size and apparent diversification can be a little misleading. Unlike pension funds and sovereign wealth funds, index funds only have exposure to public markets, and many of them concentrate on particular industries or sectors.[79] Even if we only consider the funds with the broadest portfolios, index funds are not exposed to private companies, and are geographically concentrated in the richest countries.[80] Thus, if the platonic ideal of the Universal Owner is one who owns a slice of the entire global economy, even the largest index funds fail to represent the entire economy. However, as noted in Section III, a failure to be completely diversified serves more to narrow down the applicability of the Universal Owner concept rather than completely places one outside of the concept. That is to say, given the absolute size and significant diversification of index funds, it seems plausible that they still bear a significant percentage of the externalities produced by portfolio companies.

The other dimension where index funds may fail to qualify as a Universal Owner is the issue of long-term orientation. This is due to the distinction between asset managers and asset owners.[81] Asset owners are pension funds, SWFs, and individual people who have legal ownership of cash and other assets.[82] Asset managers are given money by asset owners to invest, and act as agents on behalf of clients. Examples include mutual funds in public markets,[83]

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75 *About Blackrock*, BLACKROCK https://www.blackrock.com/sg/en/about-us#investor-pulse (last accessed May 25, 2021).

76 *Fast Facts about Vanguard*, VANGUARD https://about.vanguard.com/who-we-are/fast-facts/ (last accessed May 25, 2021).

77 Ilene Bieler and Carolyn Cinchon, *State Street Reports Fourth-Quarter and Full-Year 2020 Financial Results*, BUSINESSWIRE (Jan. 19, 2021) https://www.businesswire.com/news/home/20210119005565/en/State-Street-Reports-Fourth-Quarter-and-Full-Year-2020-Financial-Results#:~:text=With%20%2438.8%20trillion%20in%20assets,and%20employs%20approximately%2039%2C000%20worldwide

78 Jan Ficthner, Eelke Heemskerk, and Javeier Garcia-Bernardo, *Hidden power of the Big Three? Passive index funds, re-concentration of corporate ownership, and new financial risk*, 19 BUS. AND POL. 298, 322 (2017)

79 Roberto Tallarita, *Portfolio Primacy and Climate Change*, SSRN, 15 (2021).

80 *Id.* at 16-18.

81 BLACKROCK, WHO OWNS THE ASSETS 1 (2014).

82 *Id.*

83 *See id.* at 7 (referring to mutual funds as asset managers).

and private equity funds in private markets.[84] This neat distinction is of course complicated by the fact that asset managers, in the course of discharging their duties to clients, typically go out and buy things. Blackrock's index funds (which are a type of mutual fund) do own a lot of stocks. But the point of the distinction is to emphasize the money is ultimately supposed to return to the asset owner, because they have the property interest in the fund and as such can be conceived of as its owners.

Their status as mutual funds, provided by an asset manager to an ultimate asset owner raises two issues with the long-term requirement. First, these index mutual funds have no obligation to exist beyond next week, let alone ten years. This is categorically unlike the permanent nature of pension funds and SWFs. Owners of interests in the index funds can redeem them at any time in order to get liquid or simply move their money into another investment.[85] Theoretically, everyone invested in a Vanguard index fund could decide to redeem their interests tomorrow, and the fund would functionally end. Alternatively, depending on the terms of the investment contract, the asset manager could have the power to close up shop and return the value of outstanding interests to their owners. Thus, it seems possible that the lack of a firm requirement to be sustainable for the long-haul could make the provider of an index fund less concerned about externalities whose costs will be borne in the future. This issue can only take you so far though. Presumably, Blackrock and Vanguard think they have a good business model in sponsoring these index funds and want to continue to be in business in the coming decades, and presumably there will always be a substantial number of investors interested in these products.

The second issue concerns the fact that asset owners usually have options with where to put their money. Vanguard and State Street are often competing for customers, and so may be biased towards short-term performance (and minimally low costs of operation) in order to attract customers. While it is true that the same short-term pressures can exist on managers of pension funds, it is not the same as the rational institutional interest that Vanguard may have in maximizing short-term returns. Again, this not does completely defeat the notion

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84 *See Private Equity*, J.P. MORGAN ASSET MANAGEMENT, https://am.jpmorgan.com/us/en/asset-management/institutional/investment-strategies/alternatives/private-equity/ (last accessed May 25, 2021).

85 *See Mutual Fund Redemption*, U.S. SEC, https://www.investor.gov/introduction-investing/investing-basics/glossary/mutual-fund-redemptions (last accessed May 25, 2021) (stating that mutual funds must pay redemption proceeds within seven days of receiving a redemption request from a shareholder); Brian Mathews, *How Purchases and Redemptions Impact Index Funds*, MUTUALFUNDS.COM, (Dec. 6, 2016) https://mutualfunds.com/index-funds/how-purchases-and-redemptions-impact-index-funds/ (explaining how redemption requests work).

that index fund providers can have a long-term orientation, as since they are required to own companies (of a certain size) for essentially forever (or as long as they are in business) presumably they will be interested in the long-term health of their portfolio companies.

Thus, I think it is fair to say that while the Big Three index fund providers are not a perfectly clean fit into Universal Owner theory, they are close. Supporting this "middle-ground" position on the Big Three, is the fact that these entities have sent mixed signals on issues where Universal owners should (theoretically) be more concerned with portfolio wide risks, than with maximizing idiosyncratic firm-specific returns.[86]

## III. SHAREHOLDER PRIMACY VERSUS STAKEHOLDERISM

### A. *Sustainable Growth Primacy*

Assigning Universal Owners a proper view on the shareholder primacy versus stakeholderism debate is a tricky task, in part because there are multiple ways to frame the debate. One sense of the concepts focuses more on accountability questions: To whom should managers and board members be accountable to?[87] Another way to frame the accountability camp is to say that shareholder primacy means directors must obey the wishes of their actually existing shareholder base, usually by giving more power to shareholders.[88] From this perspective, the Universal Owner should fall clearly in the camp of shareholder primacy. The discussion around Universal Owners usually emphasizes the "universal" aspect of the concept, but we should not forget that

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[86] Compare Michael J. Coren, *Blackrock is forcing finance to take climate risk seriously*, QUARTZ, (Jan. 16, 2021) https://qz.com/1957979/blackrock-is-forcing-wall-street-to-take-climate-risk-seriously/#:~:text=A%20fundamental%20reshaping%20of%20finance%3A%20BlackRock%20CEO%20Larry%20Fink%20put,change%20will%20transform%20the%20business.; Matt Philips, *Exxon's Board Defeat Signals the Rise of Social-Good Activists*, N.Y. TIMES, June 9, 2021 (noting that Blackrock supported Engine Number 1's campaign against Exxon) Levine, *Index funds will save us*, *supra* note 57. *with* Tallarita, *supra* note 79 (arguing in the context of climate change that index funds' overrepresentation in rich emitter countries, the imperfect nature of the stock market as a mechanism for addressing climate risk, and the agency problems of index fund managers all suggest that the portfolio incentives of index funds are inadequate for changing corporate behavior) and Christine Williamson, *BlackRock won't back climate shareholder proposals it considers too prescriptive*, PENSIONS& INVESTMENTS, May 10, 2022 (noting that Blackrock announced it would scale back support of shareholder resolutions on climate change).

[87] *See* LENORE PALLADINO AND KRISTINA KARLSSON, TOWARDS 'ACCOUNTABLE CAPITALISM': REMAKING CORPORATE LAW THROUGH STAKEHOLDER GOVERNANCE 3 (2018) (identifying the corporation's board owing fiduciary duties solely to shareholders as a core component of shareholder primacy); *id.* at 6 (reform proposals 2 and 3 arguing for redefining board fiduciary duties to consider other stakeholder interests and adding stakeholder representation to boards of directors).

[88] Ann Lipton, *Shareholder Divorce Court*, 44 J. OF CORP. L. 297, 301 (2018).

they are still "owners". Indeed, their interests are in a sense, the interests of the ownership class as such. And, as discussed in section II.A, the Universal Owner still maintains the interest in protecting the interests of capital against labor, when there is a fundamental conflict between the two.

Another way to conceive of the debate between shareholder primacy and stakeholderism is to focus on the purpose of the corporation—what should corporations view as their goal? The shareholder primacy view is most ably put by Milton Friedman: The purpose of the corporation is to increase its profits (within the bounds of the law).[89] Thus, the purpose of the corporation is to create shareholder value. In contrast, stakeholderism stands for the proposition that corporations have either another purpose (to have a positive impact on society?) or perhaps multiple specific purposes (increase shareholder value, provide financial stability to employees, etc.).[90] The Universal Owner's view on corporate purpose should be a different version of shareholder primacy: For them, the purpose of the corporation is not simply to maximize shareholder value, but to contribute to the maximization of portfolio value. It does this by maximizing its own profits, net of any externalities or spillover effects (positive or negative) on the economy. Of course, all investors want companies to contribute to maximization of portfolio value, but investors with actively managed portfolios and smaller asset pools can attempt to avoid investments that bear the cost of negative externalities, and are unlikely to benefit as much from positive externalities. Thus, if a firm maximizes its own value even to the detriment of the value of other companies, it usually benefits the portfolio of these investors, and so the question of portfolio value maximization simply collapses into the question of individual company value maximization. To be clear, this relationship between firm value and portfolio value is a spectrum, not a binary, in the sense that as a "traditional" shareholder's portfolio grows and becomes more diversified, their perspective will begin to more resemble the Universal Owner's perspective.[91] The two ways of conceiving the debate could be two sides of the same coin but disentangling them is worthwhile because it

[89] Steven Kaplan, *The Enduring Wisdom of Milton Friedman*, HARVARD LAW SCHOOL FORUM ON CORPORATE GOVERNANCE, (Sept. 30, 2020).

[90] *See* BUSINESS ROUNDTABLE, STATEMENT ON CORPORATE PURPOSE (2019) (arguing the purpose of the corporation is create value for all stakeholders and not mentioning any possible accountability methods to other stakeholders).

[91] *See* Robert G. Hansen and John R. Lott, *Externalities and Corporate Objectives in a World with Diversified Shareholders/Consumers*, 31 J. OF FIN. AND QUANTITATIVE ANALYSIS 43, 43 (1996) (noting that diversified shareholders should be concerned about the effects of externalities on other firms); Jarrad Harford, Dirk Jenter, & Kai Li, *Conflicts of Interests among Shareholders: The Case of Corporate Acquisitions* 4 (Nat'l Bureau of Econ. Research, Working Paper No. 13274, 2007) 1 (finding that managers in mergers and acquisitions "consider cross-holdings when identifying potential targets").

reveals that the Universal Owner may be perfectly aligned with other shareholders in one sense (corporations are run for the benefit of shareholders) but diverge from shareholders in another sense (how corporations benefit shareholders).

One could analogize the Universal Owner's portfolio to a vast company with many pseudo-independent divisions. What should the owner of that company view as the purpose of each division? They would want the division to contribute to the profits of the firm, but not at the expense of other divisions in the firm. The strategy for increasing profits is obviously not for the division to take a bigger slice of the pie at the expense of another division, but to grow the overall size of the pie, even if it means a smaller slice for the division. When that pie is the entire economy, then growing the pie necessarily means growing the economy.

Thus, one term for the Universal Owner's version of shareholder primacy could be "Sustainable Growth Primacy". All of the externalities discussed above help or harm growth in some way. Environmental externalities and monopolistic behavior harms economic growth, while things like R&D and worker training contribute to growth. Given the close correlation between economic growth and long-term returns,[92] it would be a very good heuristic for the Universal Owner to simply focus on economic growth, caveated by the need for current growth to not harm future growth, i.e., sustainable growth. I will note that I am trying to use "sustainable" in a very broad sense: Firms' actions could hinder or help future economic growth in an environmental sense[93] or social sense.[94] Additionally, a firm's own business model can be unsustainable for itself, i.e., it is pursuing short-term earnings at the cost of greater longer-term value, such as by not investing in productivity improvements at its factories in order to maintain short-term positive earnings. As one source puts it in defining an unsustainable business: "its current earnings borrow from future earnings."[95]

As noted above and in section II.A, focusing on economic growth hides the fact that not all forms of growth are created equal, and the Universal Owner would prefer some forms of growth over others. Moreover, the Universal Owner's position would be improved without growth if it simply captured a

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92 Lippman, Rosan, and Seitchik, *supra* note 34 at 459.

93 *See generally* TRUCOST, *supra* note 1 (discussing the ways in which current business practices impose costs on the future economy.

94 *See* OECD, *supra* note 9, at 93-94 and 17-18 (discussing the impact that automating jobs could have on the middle class and the importance of a strong middle class to sustained growth).

95 MORRISON & FOERSTER AND IMPACT CAPITAL MANAGERS, LEGAL INNOVATIONS IN IMPACT INVESTING 32 (2021).

greater share of the national income. I still believe that the phrase "Sustainable Growth Primacy" best captures what the Universal Owner wants from individual firms in a manner that is neither simply stating the obvious (e.g., "Portfolio Returns Primacy") nor too opaque (e.g., "True Shareholder Value"). Instead, it captures that Universal Owners want their firms to be profitable, sustainable, and good members of a much broader economic and social ecosystem. They should not care if a firm increases its profits simply by cannibalizing market share from another firm, and they should oppose firms growing in a manner that externalizes costs.

The idea that portfolio value maximization is not coextensive with firm value maximization for highly diversified shareholders has been proposed in prior work,[96] but by framing this insight as a question of corporate purpose, we can see how Universal Owners' perspective on the firm can radically deviate from the standard model.

### *B. Divergences and Overlaps with Stakeholderism*

As discussed in section III.A, Sustainable Growth Primacy differs from stakeholderism in that it still views shareholders' interest as having priority and being the prime source of accountability for managers. However, there should also be more overlap between these two views than between stakeholderism and traditional shareholder primacy. Issues like treatment of the environment and of customers, which are purely means to a greater end in traditional shareholder primacy, would be put on a level playing field in Sustainable Growth Primacy. Actions that impose environmental externalities or harm customers cannot be justified by pointing to the increased profits realized by the firm. While an enlightened shareholder primacy adherent would counter by arguing firm profits will be hurt in the long run (and thus still use firm profits as the sole relevant metric) the Universal Owner can compare those increased profits with the costs imposed on other parties. Thus, profits to the firm are no longer the only relevant metric; the effect on other parties is an equally valid metric, just like in stakeholderism.

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[96] *See* Amir Rubin *Diversification and Corporate Decisions*, 3 CORPORATE OWNERSHIP AND CONTROL 209, 209 (2006) ("most shareholders (at least in the US, UK and Canada) are well diversified and care about their portfolio value, and not the value of any particular firm. Corporate policies that encourage managers to maximize equity value may be suboptimal for these diversified shareholders") Robert G. Hansen and John R. Lott, *Externalities and Corporate Objectives in a World with Diversified Shareholders/Consumers*, 31 J. OF FIN. AND QUANTITATIVE ANALYSIS 43, 43 (1996) (Diversified shareholders "do not want value maximization to be corporate policy. Instead, shareholders want companies to maximize portfolio values. This occurs when firms internalize between-firm externalities").

Positive spillover effects also show how stakeholderism and Sustainable Growth Primacy overlap. Things like investing in R&D, charitable giving in the community, and education and training are all actions that are strongly justified by both stakeholderism and Sustainable Growth Primacy. The firm as a pillar of the community is obviously compatible with a shareholder primacy view, but it does not fit as naturally as it does when you view the firm as one part in a greater whole. The overlap between these two views can be summarized by stating that both ask firms to look at other people and institutions as genuine partners and collaborators, not as competitors or as pure means to an end.

There will be two main points of potential friction between the two views. The first is, as I have already mentioned, Sustainable Growth Primacy still prefers that managers be solely accountable to shareholders. There is a partial exception to this discussed below, but for the most part the corporation will continue to exist to serve the interests of shareholders in this view. This friction is significant, especially if one doubts the ability of Universal Owners and other investors to effectively monitor firms and push them to engage in all the actions that the Universal Owner should theoretically want. The second potential point of friction between the two views will be with the stakeholder of workers. Not to punt on the question, but I believe the extent to which there will truly be conflict between the groups comes down to an empirical question about growth. I personally believe, and there is some evidence to do so,[97] that sustained, strong economic growth requires a healthy middle class and redirecting income and power to workers can help the economy overall. That being said, it is obviously an empirical question where particular policies or institutions that serve to increase the power and income of workers also contribute to economic growth enough that it outweighs any decreased profits to shareholders.

### *C. Divergences and Overlaps with Traditional Shareholder Primacy*

I use the term "traditional shareholder primacy" to emphasize that Sustainable Growth Primacy is a form of shareholder primacy. For the most part, I have already addressed the divergences and overlaps between these two views. They both agree that the current corporate governance model where managers are agents of shareholders, and accountable primarily to them, is the appropriate way to structure corporate governance. They also both agree that maximizing returns writ large should be the goal of corporations, and they disagree as to whether that should be the goal of individual firms. Thus, they will have significant non-overlap concerning the decisions where the NPV of an action

97 OECD, *supra* note 9.

(adjusted for risk, etc.) is positive for the firm, but negative when externalities are accounted for. Conversely, the Sustainable Growth Primacy view would see it as desirable for firms to take actions with negative NPV when the positive externalities are great enough to render the NPV of the decision positive on the whole. Many of the areas of agreement between stakeholderism and Sustainable Growth Primacy discussed in the prior section can be flipped here, except of course that the shareholder primacy advocate would agree that firms could engage in such actions if it improved shareholder value through improvements in brand value, reputation, customer loyalty, or employee loyalty.

It is worth addressing further how the rise of ESG investing complicates this story. As discussed in section II.C, on a conceptual and theoretical level the Universal Owner and the ESG investor are not interested in the same thing, even if their interests are closer than the Universal Owner and the socially neutral investor. However, it is worth noting that if more and more investors come to identify as ESG investors, this distinction might cease to be anything more than theoretical. If ESG investors sincerely believe that most negative externalities will eventually be internalized by firms, their version of corporate purpose will also be one where corporations need to consider externalities. The best answer is that alignment between the two views will happen more strongly when it is highly likely externalities will be forcibly internalized, and divergences will happen when that is not so. For example, given the extreme visibility of the issue, it is fairly plausible that carbon-intensive companies will have to internalize at least some of the externalized cost of carbon emissions. In contrast, it may be less likely that firms will be forced to internalize the costs of their waste streams in the near future,[98] which means they will continue to harm Universal Owners without their being a plausible path to forcible internalization. Secondly, the issue of positive externalities will also remain. Again, an ESG investor may convincingly argue that creating positive externalities helps the brand image of a firm or improves employee performance. But if it is implausible to believe that a heavy manufacturer’s industrial R&D programs will generate so much goodwill as to allow the firm to completely capture the spillover benefits, then shareholder primacy and Sustainable Growth Primacy would have divergent views on the appropriate level of R&D. More than any specific disagreement as to the appropriate amount of a given activity, the point is a Universal Owner adhering to Sustainable Growth Primacy would want corporate managers have a fundamentally different mindset when considering engaging in activities that have positive spillover effects like R&D programs and

[98] *See* TRUCOST, *supra* note 1 at 4 (reporting the externalized cost of general waste).

worker education and training. An inability for a firm to capture all the value created is not something to be worried over in Sustainable Growth Primacy.

## IV. IMPLEMENTATION ISSUES AND POSSIBLE TOOLS FOR UNIVERSAL OWNERS TO OVERCOME THEM

### *A. Heterogenous Shareholder Interests*

The fact that the Universal Owner's rational, returns-maximizing view on corporate purpose diverges in substantial ways from traditional shareholder primacy is an example of how a core assumption underlying modern corporate governance is inaccurate. This is the assumption that shareholders have homogenous interests with respect to the firm they are invested in.[99] In fact, in many situations, shareholder interests and preferences are heterogenous. Indeed, as one 2015 paper points out, all shareholders are either humans with consciences or fiduciary institutions working on behalf of humans with consciences and so (one would hope) that for all shareholders who are not sociopaths "there is some body count that would be unacceptable for a set level of profits."[100] This demonstrates that most shareholders do consider morality in some form when considering whether they would want a portfolio company to take an action that would increase profits.[101] And of course, the fact that most people have different senses of ethics and morality means that in most situations, shareholders would not agree with each other about the proper weight to assign moral concerns.

Shareholders can have heterogeneous preferences as a result of their financial and economic interests as well. Preferences can diverge when shareholders are also debtholders of the firm, or when they are also employees. The former may be more risk-averse than the typical shareholder (as their debt interests will not capture any upside) even when a firm action may be risky but still have a positive NPV.[102] Similarly, one would expect shareholder-employees to resist cost cutting measures that cut labor costs (i.e., layoffs or slashing of benefits), even if there was strong reason to believe that such actions would have

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[99] Andrzej Rapaczynski, *Impact Investing as a Form of Lobby and its Corporate Governance Effects*, 11 CAPITALISM AND SOCIETY 1, 1 (2016).

[100] Paul D. Weitzel and Zachariah J. Rodgers, *Broad Shareholder Value and the Inevitable Role of Conscience*, 12 NYU J. OF LAW & BUS. 35, 36 (2014).

[101] Weitzel and Rodgers, *supra* note 100 at 43.

[102] Generally, one would expect a shareholder with at least some diversification to almost always prefer firms to take actions with a high NPV, even if they are highly risky. *See* Ying Dou, Ronald Masulis, & Jason Zein, *Shareholder Wealth Consequences of Insider Pledging of Company Stock as Collateral for Personal Loans*, ECGI Working Papers in Finance, 3 (2019).

a positive NPV. With the rise of Silicon Valley and venture-backed firms, one increasingly important source of heterogeneity is the conflict between preferred shareholders and common shareholders. Courts have had to adjudicate disputes between venture capital shareholders who own preferred stock, and common shareholders who own common stock.[103] Finally, as noted in Section IV, diversification can give rise to divergent shareholder interests. A shareholder whose holdings are concentrated in the firm will have different preferences, than a shareholder whose holdings are broadly diversified, particularly in the acquisitions context where the diversified shareholder owns equity in both the target and the acquirer.[104]

The upshot of this heterogeneity isn't simply that it is interesting from an academic perspective, but that if some of the suggested tools of corporate governance rely on the basic assumption of homogenous shareholder interests, the realty of heterogenous interests can undercut their utility. Corporate governance exists to solve the perceived core conflict in corporations—that of the conflict between the principals (shareholders) and the agents (managers) in the corporate relationship.[105] Implicit in this picture is the idea that shareholders have the same interests with respect to the corporation.[106] However, if the principals themselves have serious conflicts, it makes treating them as a unitary whole less sensible. In particular, the existence of heterogenous interests means the rationale for the shareholder franchise breaks down.[107] The reason for this is it is argued shareholder voting is valuable in two ways.[108] It reduces agency costs by allowing shareholders to punish misbehaving directors or replace them, and it acts as a coordination mechanism to allow shareholders to express their preferences to the directors.[109] Because both of these arguments are rooted in the assumption that shareholders have a uniform set of preferences and goals, the

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[103] *See Frederick Hsu Living Trust v. Oak Hill Capital Partners III, L.P.*, 2020 WL 2111476, 1-2 (Del. Ch. 2020) (summarizing that the dispute was between common shareholders and the leading venture capital firm concerning the fairness of how the common stock was treated); *In Re Trados Inc. Shareholder Litigation*, 73 A.3d 17, 20 (Del. Ch. 2013) (summarizing opinion by noting this is a dispute between VC directors and a common shareholder arising out of their different liquidation preferences).

[104] Jarrad Harford, Dirk Jenter, & Kai Li, *Conflicts of Interests among Shareholders: The Case of Corporate Acquisitions* 4 (Nat'l Bureau of Econ. Research, Working Paper No. 13274, 2007).

[105] John Armour, Henry Hansmann, and REINIER Kraakman, AGENCY PROBLEMS, LEGAL STRATEGIES, AND ENFORCEMENT, 2 in the ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH, Reinier Kraakman, et al. (2009).

[106] *Id.*

[107] Ann Lipton, Shareholder Divorce Court, 44 J. of Corp. L. 297, 304 (2018) citing Rapazynski; Martin/Portnoy.

[108] *See id.*

[109] *Id.*

existence of heterogeneous preferences undercuts both arguments.[110] Not only could it make the franchise less effective at both of these functions, the problem of shareholder oppression[111] means **that placing more it has been argued** that placing more power in the hands of shareholders could lead to unfair treatment of the minority, or destruction of shareholder wealth by allowing the majority to advance their private interests at the expense of the good of the corporation.[112]

Thus, resolving how to negotiate conflicts of interest between shareholders is an important question for corporate law. There has been an increase in efforts, especially at the level of federal securities law, to facilitate increased shareholder power relative to managerial power,[113] which would in practice empower the majority camp in situations of shareholder conflict. However, in large part corporate law has consistently that since fiduciary duties are owed to the corporation, and not to shareholders directly, directors and managers have a duty to maximize the value of the corporation.[114] Because shareholders are the residual claimants of the firm,[115] maximizing the value of the firm collapses into maximizing shareholder's equity stake, which is seen to be in the best interest of the shareholder:

> I take it as non-controversial that, under established and conventional conceptions, directors owe duties of loyalty to the corporation and to the shareholders; that this conjunctive expression is not usually problematic because the interests of the shareholders as a class are seen as congruent with those of the corporation in the long run.[116]

As a corollary to this, directors' duties to shareholders stop at the water's edge of the corporation. Moreover, the caselaw makes clear that when the preferences of shareholders are incongruent with maximizing the value of the corporation, directors are under no fiduciary obligation to obey them.[117] As *In*

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110 *Id.*

111 Gerard Mantese & David Hansma, *Shareholder Oppression, Fiduciary Duty, and Partnership Litigation in Closely Held Companies,* SRR JOURNAL SPRING (2014).

112 Iman Anabtawi, *Some Skepticism about Increasing Shareholder Power*, 53 UCLA. L. REV. 561, 561 (2005).

113 Lipton, *supra* note **Error! Bookmark not defined.** at 314.

114 *TW Services, Inc. v. SWT Acquisition Corp.*, 1989 WL 20290, 7 (Del. Ch. Ct. 1989), In re Trados,

115 *TW Services, Inc* supra at note 117; *In re Trados* supra at note 117.

116 *TW Services, Inc* supra at note 117.

117 *See In Re Trados*, *supra* note 102103 at 38 ("Stockholders may have idiosyncratic reasons for preferring decisions that misallocate capital. Directors must exercise their independent fiduciary judgment; they need not cater to stockholder whim"); *Paramount Communications Inc. v. Time Inc.*, 1989 WL 78880, at 30 ("The corporation law does not operate on the theory that directors, in exercising their powers to manage the firm, are obligated to follow the wishes of a majority of shares. In fact, directors, not shareholders, are charged with the duty to manage the firm").

*Re Trados*, a recent case in this line put it: "Stockholders may have idiosyncratic reasons for preferring decisions that misallocate capital. Directors must exercise their independent fiduciary judgment; they need not cater to stockholder whim."[118] In sum, insofar as it is accurate to say that directors and managers owe a fiduciary duty to shareholders, it is only qua shareholders of the particular company they manage. That is to say, fiduciary duty does not require managers to care about the other holdings and interests (financial and otherwise) of the shareholders of their company—it does require them to care about the value of one particular holding (the company that they manage).[119]

From this core point, it follows that not only do directors not have an obligation to listen to shareholders' "whims", doing so could be in breach of their fiduciary duty if it would harm the value of the firm. Thus, one could say that directors manage the company not on behalf of actually existing shareholders, but on behalf of a hypothetical, idealized, shareholder: The shareholder's whose only concern is maximizing the long-term value of their investment into the firm. For the actual shareholders, directors are required to manage the company in accord with their preferences to the extent that their preferences conform to this platonic ideal of a shareholder. Thus, we have a principle for resolving conflicts between shareholders with heterogenous interests: Directors and managers are obliged to side with the shareholder whose preference more closely aligns them with this hypothetical idealized shareholder—who cares about nothing other than the value of their investment.

For shareholder-debtholders, directors have no fiduciary duty to maximize the value of their debt instruments, because that financial interest does arise from their capacity as a shareholder. For shareholder-employees, directors have no fiduciary duty to maintain protect their labor interests, because that interest does not arise from their capacity as a shareholder. Finally, for preferred stockholders, directors have no fiduciary duty to protect their special contractual rights,

[118] *In Re Trados, supra* note 102103 at 38.

[119] *See supra* note 114; *The Delaware Way: Deference to the Business Judgment of Directors Who Act Loyally and Carefully*, DELAWARE CORPORATE LAW, https://corplaw.delaware.gov/delaware-way-business-judgment/#:~:text=Delaware%20law%20requires%20directors%20to,consideration%20to%20their%20self%2Dinterest.&text=Generally%2C%20the%20duty%20of%20loyalty,to%20a%20director's%20personal%20motive (last accessed May 25, 2021) ("Broadly stated, the duty of loyalty requires directors to act in good faith to advance the best interests of the corporation and, similarly, to refrain from conduct that injures the corporation.") (emphasis added); *Smith v. Van Gorkom*, 488 A.2d 858, 872-73 (1985) (stating that the duty of care requires exercising an "an informed business judgment" and that the business judgment rule presumes 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.") (emphasis added).

because it does not arise from their capacity as a shareholder.[120] Similarly, with respect to heterogenous moral beliefs and risk preferences, directors are obliged to act in accordance with these preferences only to the extent they reasonably believe such preferences align with the long-term value of the company. While of course for some of these groups these groups there are contractual rights that directors and managers must honor, when they are making discretionary decisions, they cannot privilege the interests of these groups above the interests of the shareholders who lack such idiosyncratic interests. In *In re Trados*, the Delaware Chancery Court found that VC directors (who were holders of preferred stock) did not meet the standard of conduct with respect to fair dealing in negotiating an acquisition of the company, precisely because they failed to act from the perspective of regular stockholders:

> In this case, the VC directors pursued the Merger because Trados did not offer sufficient risk-adjusted upside to warrant either the continuing investment of their time and energy or their funds' ongoing exposure to the possibility of capital loss. An exit addressed these risks by enabling the VCs to devote personal resources to other, more promising investments and by returning their funds' invested capital plus a modest return. The VC directors did not make this decision after evaluating Trados from the perspective of the common stockholders, but rather as holders of preferred stock with contractual cash flow rights that diverged materially from those of the common stock and who sought to generate returns consistent with their VC funds' business model.[121]

The efficient markets hypothesis could be applied to argue that conflicts between shareholder interests are not problematic, even for the shareholder who potentially "loses" from the resolution of the conflict, because if the resolution is viewed as suboptimal by the marketplace as a whole, the share price will be negatively affected. In an efficient market, the current stock price will reflect the market's perception of the firm's long-term to generate cash.[122] The efficient markets hypothesis proposes that in a sufficiently efficient market, such as the public stock market, all publicly available information is reflected in the stock price.[123] If a firm makes a decision, and a sufficient share of the marketplace

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[120] *See In Re Trados*, *supra* note 102103 at 39-40 ("A board does not owe fiduciary duties to preferred stockholders when considering whether or not to take corporate action that might trigger or circumvent the preferred stockholders' contractual rights. Preferred stockholders are owed fiduciary duties only when they do not invoke their special contractual rights and rely on a right shared equally with the common stock").

[121] *Id.* at 56

[122] Burton G. Malkiel, *The Efficient Market Hypothesis and its Critics*, 17 J. OF ECONOMIC PERSPECTIVES 59, 59 (2003).

[123] *Id.*

believes the decision negatively affects the long-run prospects of the firm, then the share price of the firm will be negatively affected. Thus, regardless of how corporate law addresses shareholder conflicts, the market will be reward those firms whose resolution is perceived to enhance the long-term value of the company and punish those firms whose resolution does not. While this claim has been proposed in the context of conflicts between short-term and long-term shareholders, the same basic principle could apply to other cases of shareholder conflict. For example, in the case of shareholders with different risk preferences, an efficient market will adjust the expected value of future cash flows according to the perceived riskiness of the firm's strategy. Thus, if one buys this story, then the problem of heterogenous shareholder interests really is not a problem at all in many cases, because the market will incorporate shareholder preferences in pricing stocks, even when corporate law resolves against certain groups of shareholders.

### *B. Heterogenous Shareholder Interests and Universal Owners*

The relevancy of the issue of heterogenous shareholder interests and Universal Owners should be obvious. A Universal Owner may own shares in many companies, but rarely would it be a majority owner on its own. It may have an interest in the company internalizing externalities, but from a purely profit-maximizing perspective the non-universal owners in the company likely do not. It is powerless to affect corporate change then. The problem gets a little better if it is the case that Universal Owners collectively own a majority of the company. If we consider the Big Three to be Universal Owners, then this is likely the case for many publicly traded U.S. companies.[124] In this scenario, if the Universal Owners all agree on some form of Sustainable Growth Primacy, they can act to make their voices heard at the company. Whether through voting for directors or engaging with the directors, the problem at this point becomes more of a collective action problem (which of course is significant in its own right). If they succeed, managers will be forced to listen to them (since they are a majority). However, for most companies it will likely be the case that there are also shareholders who lack the Universal Owner perspective. Whether retail investors, actively managed mutual funds, hedge funds, or others, there will almost certainly be investors whose lack of size, diversification, or long-term orientation gives them a different perspective on the purpose of the corporation. In other words, heterogeneity of interests. As discussed in the prior section,

[124] *See* A. DE LA CRUZ, ET AL., OWNERS OF THE WORLD'S LISTED COMPANIES 11, 6 (2019) (reporting that 72% of all owned equities in the U.S. are owned by institutional investors and the "the average combined ownership held by a company's 10 largest institutional investors is 43%").

when shareholders have heterogenous interests, the fact that 1) fiduciary duties are owed to the corporation and not the shareholders and 2) the content of such duties require managers to maximize the long-term value of the corporation, means that the shareholder whose interest most aligns with 2) will be the shareholder whose interests are protected. In many scenarios, if the Universal Owners are able to elect boards that align with their interests, the managers will be able to take Universal Owner-friendly actions. Under the business judgement rule managers can be protected in taking actions to internalize negative externalities or reduce the deadweight loss in an oligopolistic market, so long as they can plausibly argue they were doing so to promote long-term shareholder value.[125] As discussed in previous sections, there are plausible arguments that reducing production of negative externalities and increasing production of positive externalities will improve the long-term value of the company, through enhanced reputational benefits or reduced regulatory risk.

However, there is a fundamental limitation on how far managers can go with these Universal Owner-friendly actions. They cannot take actions that they believe would destroy firm value (even if it benefits the majority of their shareholders) without triggering a credible claim of breach of fiduciary duty on the part of their shareholders. Thus, the more radical potential implications of Sustainable Growth Primacy cannot be realized. Consider the example of drug pricing discussed in II.C.iii. Suppose Universal Owners seized control of a majority of the shares of one of the three manufacturers of insulin in the United States.[126] The Universal Owners may have very good empirical evidence and modeling to support the proposition that slashing insulin costs would be so beneficial to the U.S. economy that it would redound to their benefit even if the company saw lower profits over the long-term. Management's ability to implement this vision[127] would be fundamentally constrained by the fact that it would have to be justified in terms of maximizing long-term shareholder value of this particular company. While it is not implausible to argue cutting prices would build goodwill with customers and regulators, and it would enable the company to gain a larger market share at the expense of competitors, that

[125] *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (1971) (stating that when the business judgment rule applies "A board of directors enjoys a presumption of sound business judgment, and its decisions will not be disturbed if they can be attributed to any rational business purpose").

[126] William T. Cefalu, *Insulin Access and Affordability Working Group: Conclusions and Recommendations*, 41 DIABTES CARE 1299, 1300 (2018).

[127] This of course assumes management has a desire to do so—they may have independent motivations to resist what they perceive to be radical changes to the firm's purpose. But in this discussion, we can assume that if the Universal Owners can apply the right pressure to the board, they can have some success finding the right managers to implement their vision, or as discussed *infra* compensate managers in a manner that aligns incentives.

argument can only take you so far. First, the price to which they could cut insulin and still plausibly claim they were maximizing shareholder value may be higher than the optimal price from a Sustainable Growth Primacy perspective. Second, it just requires management and the Universal Owners to engage in an ungainly rigmarole, where they have to hide their true intentions and true goals for the company.

It should also be noted that the solution of "efficient markets" is particularly unsatisfactory for Universal Owners. The efficient markets hypothesis states that all publicly available information related to a firm's prospects will be reflected in the share price.[128] At best for the Universal Owners, an efficiently priced firm will reflect the potential for regulatory risk or other risks related to a firm's production of externalities. However, as discussed in section II.C.i, this argument (essentially the one ESG investors make) is categorically different from the argument Universal Owners make, which is that they face costs from firm behavior that are unrelated to the firm's ability to generate cash flows and will persist even if the firm is never forced to internalize such costs.

The problem of heterogenous shareholder interests has been surprisingly ignored in the literature on Universal Owners, including critiques of the Universal Owner concept. The one source that spent any time on the issue was Lippman et al.: They briefly argue that Universal Owners should focus on government policy changes to achieve the goal of lower drug price, because corporate boards will be reluctant to reduce profits as they "have their own fiduciary duties to act in the long-term interest of company shareholders."[129] The next closest to this point comes from Gjessing and Syse, whose critique focuses on management perspectives rather than fiduciary duties, but drives at the same point:

> The purpose of companies is to set capital to work. What investors, as owners, ask company management to do is to obtain the highest return possible on the capital. This is the simple, yet powerful, mission of investment. This does not capture external effects, and investors may therefore engage with management (boards can in this respect be seen as part of the management) to try to persuade the company to take into account not only the return on capital in that company, but also more complex investor interests…investors must ask themselves whether they have much persuasive power when on the one hand they hold management responsible for achieving the required rate of return, and on the other hand challenge them to forego profitable opportunities for

[129] Lippman, *supra* note 34, at 465.

> the sake of something the investor, in a discretionary way, characterises as their portfolio interests…Hence, asking management to divert from profit maximisation in order to pursue a portfolio interest of the investor will be difficult, especially when universal owner arguments are still the exception rather than the rule.[130]

This is an older source, and so does not consider the growth in interest in ESG investing and new forms of corporate purpose, but it lines up with the fiduciary duty issues identified here. Searching the rest of the literature for discussions of fiduciary duty, one only finds discussions of duties owed by pension fund trustees to beneficiaries.[131] Before moving into some proposed solutions, I will speculate and add that the existence of this problem perhaps explains why, if Universal Owners are trying to implement their vision at portfolio companies, their level of success has varied from issue area to issue area. Corporate governance has long been identified as an area of interest to Universal Owners because they have an interest in standardized, shareholder-friendly governance across the entire economy,[132] and it is also an area where pension funds like CalPERs have been credited as being highly successful activists.[133] It may not be a coincidence that this is an area where non-Universal Owner interests clearly align with theirs. In contrast, it was only with the recent explosion of interest in climate change and ESG investing have we begun to see any traction in shareholders forcing fossil fuel companies to internalize their negative externalities.[134]

My first suggestion for addressing this problem cuts across all three of the next suggestions but is worth highlighting in its own right. Universal Owners should work together on these issues as much as possible. Collaboration is a frequently proposed strategy for Universal Owners because it solves the collective action problems generated by the fact that each Universal Owner would prefer the others to bear the costs of changing portfolio company behavior, since they all gain from any improvements.[135] But it is an important suggestion for overcoming collective action problems and enabling the pooling

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130 Gjessing and Syse, *supra* note 22**Error! Bookmark not defined.**, at 434.

131 *See* Quigley, *supra* note 4 at 6 (summarizing the debate on the fiduciary duty of Universal Owners).

132 *See* James Hawley and Andrew Williams, *Universal Owners: challenges and opportunities*, 15 CORP. GOVERNANCE AN INT'L REV. 415, 416 (2007 ("In our research and writings we have always viewed corporate governance as a core part of fiduciary capitalism generally, and of the universal owner hypothesis specifically"); Thamotheram and Helen Wildsmith, *supra* note 4, at 438.

133 *See* YiLin Wu, *The impact of public opinion on board structure changes, director career progression, and CEO turnover: evidence from CalPERS' corporate governance program*, 10 J. OF CORP. FIN. 199, 199 (2004).

134 Steven Mufson, *A bad day for Big Oil*, WASHINGTON POST, (May 26, 2021).

135 Thamotheram and Helen Wildsmith, *supra* note 4, at 440; CONFERENCE REPORT, *supra* note 6, at 7.

of resources for institutions like pension funds that—as rich as they are on paper—are often underfunded relative to liabilities.[136] Importantly, given that some boards may resist even moderate changes in the direction of Sustainable Growth Primacy, it is plausible that Universal Owners would have to work together to nominate and elect a full new slate of board members.

The second suggestion is to work to persuade the non-Universal Owner investors to support a vision of corporate purpose that is, if not Sustainable Growth Primacy, a more expansive, long-term, notion of shareholder primacy. In other words, try to convince your fellow shareholders to become ESG investors, whether at the company level or at the market level. This will help increase buy-in for at least some actions that are in accord with Sustainable Growth Primacy, though as noted in section IV.C it may have a ceiling, depending on the issue area.

The third suggestion is to focus on government policy as the avenue for implementing Sustainable Growth Primacy. This has been suggested in the literature on Universal Owners as well.[137] After all, the classic story of externalities is that they are a market failure that demands government intervention to correct. Universal Owners may have an interest in forcing companies to internalize their negative externalities and producing more positive externalities. But just because one has an interest, does not mean one has the power. Governments have the power to regulate environmental harms and other social ills. On the positive externalities side, it may make more sense for Universal Owners to prefer higher taxes and government provision of goods like worker training and research, rather than firms. This proposal solves the Corporate Fiduciary Duty issue because managers' obligation to obey the law outweighs any duty to maximize profits. Pursuing policy changes rather than trying to force through radical changes at the corporation also helps with a similar problem: Even if Universal Owners are a majority and able to coordinate such that they can pressure boards, unless they are able to successfully elect a board that shares their vision, managers may resist actions they think would

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[136] *See* Walters, *supra* note 25.

[137] Lippman, *supra* note 34, at 465; TRUCOST, *supra* note 1 at 12 (recommendation 4); Gjessing and Syse, *supra* note 22, at 432 ("Since the negative value of many external effects (and cross-effects) is so hard to predict, taking account of these data in portfolio composition is – at least in a number of cases – unlikely to add value for the fund owner. A more obvious solution, therefore, would be to ask or pressure public authorities to correct market failures, where warranted. Although government regulation may in many cases be more blunt and less flexible than business actors would ideally want, at least it is real and tangible, and helps create a level playing field for all actors, including one's investee companies").

harm firm profitability, even absent a fiduciary duty.[138] Thus, have the government bear the burden of forcing managers to implement your desired changes. To continue with the tangent, the issue of manager resistance suggests that changing standard compensation packages to better align incentives between managers and Universal Owners could be another tool in the Universal Owner toolbox. Perhaps tying some portion of management compensation to their performance on certain ESG metrics would be one method of doing so.[139]

One interesting wrinkle with the government policy route, is that it forces Universal Owners to consider the tradeoff between having less control over the precise actions of the firm (as presumably government policy will be informed by the input of other stakeholders as well) versus having a greater likelihood of success at actually changing firm behavior. In other words, if the Universal Owner concludes it cannot, through other means, convince portfolio companies to adopt sustainable growth principles for a particular issue area, it must decide whether it must live with the suboptimal firm performance or push for policies that may **have** be suboptimal in a different way.

The final suggestion is to use alternative corporate forms like public benefit corporations (PBCs). Universal Owners can push for companies to convert to these alternative forms. At first glance, PBCs seem to be the opposite of what a Universal Owner would want, since they theoretically insulate management from shareholder pressure. However, it is important to keep in mind that even in a PBC, shareholder democracy still exists. Though shareholder voting is far from a perfect mechanism of holding management accountable,[140] it is a viable avenue. If directors and officers are acting in ways that shareholders do not like, they can always vote for a new board. Thus, if Universal Owners own a majority of the corporation, its status as a PBC would not necessarily affect their ability to hold management accountable. But it would insulate management from pressure from minority shareholders. Because the PBC has a requirement that the directors "balance" shareholder value against the specific corporate interest as well as the general public interest, PBCs allow for directors to explicitly promote aims other than profit maximization, such as reducing environmental

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138 *See* Lippman, *supra* note 34, at 465 ("However, [boards] are unlikely to act to benefit universal investors at a material expense to their own company's profitability and shareholder returns. For this reason, universal investors could benefit from supporting public policies that advance their overall interest in limiting drug prices").

139 *See* Michael Drew, *The Puzzle of Financial Reporting and Corporate Short- Termism: A Universal Ownership Perspective*, 19 AUSTRALIAN ACCOUNTING REV. 295, 300 (2010) (suggesting a range of compensation options to incentivize more long-term oriented behavior from managers).

140 David Yermack, *Shareholder Voting and Corporate Governance*, 2 ANNUAL REV. OF FIN. ECON. 103, 104-05 (2010) (discussing some of the potential costs of shareholder voting).

harm.[141] The statute requires directors to balance the 1) financial interests of stockholders 2) the best interests of those materially affected by the corporation's conduct and 3) the specified public benefits identified its certificate of incorporation.[142] Therefore, in a PBC managers would not violate their fiduciary duty simply because they sacrificed some shareholder value in order to make drug prices more affordable or in order to make their operations less environmentally harmful. In one sense, this unique duty imposed on directors in the PBC shifts perspective to resemble that of the Universal Owners: Rather than narrowly focusing on extracting as much profits as possible from one firm, directors can now consider the effects of their actions on other stakeholders, e.g., the effects of unpriced externalities.

It should be noted that any of these suggestions may have undesirable other consequences for the Universal Owner. For example, if access to capital is inhibited at companies because prospective investors fear being in a minority position where they perceive they will be exploited by the Universal Owner majority faction, the corporation's long-term value may be severely diminished with no commensurate offsetting gain at other portfolio companies. This harm would of course harm the Universal Owners. As discussed above, policy changes that help solve one problem for Universal Owners could have negative consequences in a different dimension (e.g., higher taxes on corporate profits to pay for expanded higher education). The point of offering these suggestions is to illuminate the fact that resolving this problem will require Universal Owners to take potentially unorthodox steps, such as asking for greater government regulation or embracing new corporate forms.

## V. CURRENT STATUS AND FUTURE DIRECTIONS

Whether or not Sustainable Growth Primacy is embraced whole-heartedly by Universal Owners, it is useful because it helps us better understand actions taken by Universal Owners. One way to read Larry Fink's letters on corporate purpose[143] is that they are simply efforts to get portfolio companies to realize their individual long-term value is maximized by embracing a corporate purpose. And I do believe Fink believes this to be true. However, it is worth

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[141] *See* DEL. CODE. tit. 8 §365(a) (requiring directors to run the PBC "in a manner that balances the pecuniary interests of the stockholders, the best interests of those materially affected by the corporation's conduct, and the specific public benefit or public benefits identified in its certificate of incorporation").

[142] *Id*.

[143] Larry Fink, *Profit & Purpose*, BLACKROCK (2019) https://www.blackrock.com/americas-offshore/en/2019-larry-fink-ceo-letter ; Larry Fink, *A Sense of Purpose*, BLACKROCK (2018) https://www.blackrock.com/corporate/investor-relations/2018-larry-fink-ceo-letter.

pointing out that even if some companies do not see a rise in long-term value as a result of considering their impacts on society and the environment, Blackrock's portfolio will benefit regardless, if these firms reduce their production of negative externalities. Thus, Blackrock wins either way. While one could argue that the efforts by Universal Owners to push pharmaceutical companies to cooperate on Covid-19[144] was rooted in an attempt to maximize these firms' long-term value, it seems more plausible any enhanced reputational benefits were secondary to the main purpose of returning the economy (i.e., their portfolios) to a sense of normalcy and continued growth.[145]

With regards to the deadweight loss from oligopolistic markets, one study found that Big Three ownership in the airline industry is associated with lower prices.[146] The Norwegian SWF couches its work on climate change in the language of portfolio-wide, long-term "sustainable growth."[147] In their 2000 article introducing the concept, Hawley and Williams argue that the Universal Owner concept helps us understand why it is pension funds who take the lead on corporate governance efforts at individual funds, because making an example of a few firms leads to positive spillover effects at nontargeted firms (which are also owned by Universal Owners).[148] This phenomenon of "making an example" out of a few target companies could be applicable to solving the Corporate Fiduciary Duty problem. Finally, the Engine One Campaign against Exxon appears to have succeeded in electing more climate-friendly directors.[149] While it is notable that investor pressure led to this outcome, it is even more notable for this paper's purposes who voted for the new slate: The three largest pension funds in the United States, and Blackrock.[150] If Exxon actually takes action to more rapidly shift to a low-carbon business model and reduce emissions, these four Universal Owners will win either way: Either it improves shareholder value and Exxon's owners benefit, or it does not but the Universal Owner's portfolio benefits because it bears less of the externalized costs. While there are more

[144] Levine, *supra* note 57.

[145] *See also* CONFERENCE REPORT, *supra* note 6, at 18 ("The universal owners represented [in initiatives to reduce carbon emissions from utilities] are not focused on enhancing short-term returns for anyone holding. Instead, their business case for addressing climate change is in mitigating the disastrous economic consequences predicted as a result of climate change and preparing portfolio holdings for the "global shift to a lower carbon economy" foreshadowed in the mission statements of IIGC and INCR").

[146] Jose Azar and Xavier Vives, *Revisiting the Anticompetitive Effects of Common Ownership*, SSRN 28 (2021).

[147] NORGES BANK INVESTMENT MANAGEMENT, RESPONSIBLE INVESTMENT: GOVERNMENT PENSION FUND GLOBAL 13 (2019). *Id.* at 17 ("In our dialogue with companies, we raise environmental, social and governance issues that may be relevant to the fund's long-term return").

[148] Hawley and Williams, *supra* note 2, at 46-47.

[149] Mufson, *supra* note 134.

[150] *Id.*

examples, the point is not that Universal Owners have actually whole-heartedly embraced this vision of corporate purpose, but that Sustainable Growth Primacy can help us understand some of their motivations behind some of their activism.

In order to continue to implement this vision across their portfolios, work is being done to solve some of the barriers to the implementation of Universal Owner concepts at firms, such as by creating more actionable data,[151] and improving the managerial capacities of institutional investors.[152] Along with solving these problems, Universal Owners have a number of positive tools in the toolkit for implementing this vision of corporate purpose. The four suggestions in section IV.A for solving the Corporate Fiduciary Duty problem are also relevant for implementing Sustainable Growth Primacy generally, especially pushing for government policy changes. Along with these suggestions, I would add two more important tools. The first is shareholder engagement, an existing popular tool for Universal Owners.[153] Universal Owners typically do not exit companies, but they can engage with management on issues they care about. The good news for Universal Owners is that engagement can have real, lasting effects on companies. A recent paper studied the impact of environmental activist investing efforts and found that targeted firms reduced emissions of greenhouse gases and other pollutants, and increased expenditures on pollution abatement.[154] Of course, with primary market investments, such as in private markets or secondary issuances in public markets, Universal Owners can use the promise of their capital to channel issuers towards alignment with Sustainable Growth Primacy, and withhold capital from particularly non-aligned investments.[155] In contrast, in secondary markets withholding capital has little (economic) effect, and so engagement and voting are more important strategies.[156]

Finally, if sustainable growth will be the goal of Universal Owners, they will need a set of metrics and measurements that quantify a company's contribution to, or detraction from, sustainable growth. These metrics may overlap with, but are not the same as, the work being done by the Sustainable Accounting Standards Board (SASB) to create ESG metrics that are financially material for

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[151] *Supra* notes 46 and 47.

[152] *See Institutional Investment*, STANFORD GLOBAL PROJECTS CENTER, https://gpc.stanford.edu/research/institutional-investment (last accessed May 25, 2021).

[153] Kieran, *supra* note 26, at 482 (suggesting engagement with portfolio companies); TRUCOST, *supra* note 1 at 11.

[154] Lakshmi Naaraayanan, Kunal Sachdeva, and Varun Sharam, *The Real Effects of Environmental Activist Investing*, 743/2021 EUROPEAN CORP. GOVERNANCE INST. FIN. WORKING PAPER, 1 (2021).

[155] Quigley, *supra* note 4, at 21-22.

[156] *Id.*

investors.[157] As this paper has made clear, what is material to a Universal Owner may not be material even to an ESG investor. In essence, Sustainable Growth Primacy suggests that it would be desirable for companies to produce balance sheets with all of its "true" liabilities and expenses, as well as its "true" assets and revenues, i.e., its positive and negative spillover effects. To give one tangible example, natural capital accounting is a method of valuing ecosystem services, in order to assess the true costs of developing a given area.[158] Sustainable Growth Primacy suggests that companies, when making decisions that affect ecosystems, should use natural capital accounting to assess whether losses of natural capital are greater than the positive cash flows generated by the decision. If so, then it is possible that the net effect on Universal Owners' portfolios would be negative.

## CONCLUSION

With the massive growth in index strategies and the continued growth of large asset owners like pension funds and sovereign wealth funds, there is little doubt that the Universal Owner will continue to be an important concept for our understanding of modern capitalism. As this paper makes clear, their unique economic interest means they should have a perspective on corporate purpose that is fundamentally different from either the traditional shareholder primacy view or the stakeholderism perspective. However, just because they have a unique interest and are powerful players does not mean their interest will always be translated into a real-world impact. There are serious legal, institutional, and epistemic (i.e., relating to actionable data) barriers that can prevent Universal Owners from advancing this notion of corporate purpose. While there are positive trends from their perspective (the rise in ESG investing, growth in sophisticated modeling of some externalities) it is by no means certain their vision of corporate purpose will prevail. How Universal Owners attempt to overcome these barriers, and whether they are successful, will have important consequences for the continued development of modern capitalism and the response to the climate crisis.

157 *About Us*, SASB, https://www.sasb.org/about/ (last accessed May 25, 2021).

158 *Who we are*, NATURAL CAPITAL PROJECT, https://naturalcapitalproject.stanford.edu/who-we-are/natural-capital-project (last accessed May 25, 2021).