THE HIDDEN COST OF M&A

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The shareholder wealth maximization norm exerts tremendous influence on both business practice and corporate legal scholarship. Widespread acceptance of the norm has produced substantial focus among corporate executives, analysts, and scholars on one key metric: share price. The norm and the related focus on equity prices rest on two key assumptions: (1) that the pursuit of shareholder wealth maximization, as measured by share price, effectively maximizes the wealth of actual shareholders and (2) that the pursuit of shareholder wealth maximization, as measured by share price, is socially beneficial. If the shareholder wealth maximization norm does not truly maximize shareholder wealth, it fails by its own terms. If pursuing shareholder wealth maximization does not produce a net social benefit but instead generates a net social harm, the pursuit of shareholder wealth maximization no longer constitutes a "win-win" for businesses and consumers but instead elevates business interests in a zero-sum competition between the two groups.

This Article addresses one context where the pursuit of share price gains both fails to maximize the wealth of all shareholders and fails to benefit society: corporate mergers and acquisitions activity. Since Henry Manne's seminal paper, The Market for Corporate Control, *it has been generally accepted that merger gains accrue either through efficiency or market power. Efficiency gains involve creating synergies and eliminating redundancies, thus enabling merged entities to do more with less. To the extent that merger gains accrue via this route, mergers benefit everyone involved: shareholders benefit from a boost in share prices, society benefits from a more efficient marketplace, and consumers benefit from lower prices for goods*

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and services. In contrast, market power gains enable the merged entity to increase the price of the goods it sells or the services it provides, thereby reducing consumer welfare. Because of the increased cost to consumers, this second option pits the interests of some groups against others. Wealthy shareholders likely benefit more from share price increases than they are harmed by the increased cost of goods and services, since these shareholders tend to own substantial amounts of stock and to make substantial sums from that stock. However, the reverse may be true for less wealthy shareholders and society at large. Corporate legal scholarship has largely failed to address this hidden cost.

Historically, economic literature has left unsettled whether merger gains accrue primarily through the former or latter routes, leaving scholars free to assume that merger gains do not necessarily come at the expense of consumers or society. Recent research, however, reveals that most gains in U.S. mergers come from market power increases. This finding exposes two key shortcomings of traditionalist interpretations of the shareholder wealth maximization norm: (1) share price gains serve as an inadequate proxy for increased financial welfare for all shareholders, and (2) share price gains serve as an inadequate proxy for increased social welfare. If we truly desire to maximize the wealth of all shareholders and to benefit society as a whole, then we cannot rely on share price gains as a proxy for the interests of all constituencies.

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This Article seeks to answer two questions. First, does the shareholder wealth maximization norm, as currently understood, actually result in wealth maximization for a typical shareholder? Second, does pursuing shareholder wealth maximization benefit or harm society at large? Complete answers to these questions would require an analysis of all corporate activity. This Article instead attempts to answer these questions within a narrow scope—in the context of corporate mergers and acquisitions (collectively, "M&A").

Empirical evidence suggests that, to the extent that M&A activity generates returns to shareholders, these gains accrue largely through socially harmful increases in market power rather than through socially beneficial increases in

efficiency.[1] M&A activity that increases efficiency can create wealth for both consumers and shareholders: consumers benefit from lower prices and the firm (i.e., the shareholders) benefits from increased profits. M&A activity that increases market power raises the price of goods and services. Although this price increase is profitable for the firm, consumers pay higher prices while receiving no corresponding increase in value for themselves.

Since M&A gains accrue through market power increases and not efficiency increases, these gains result not from wealth creation, but from wealth transfers. Importantly for purposes of shareholder wealth maximization, these wealth transfers sometimes come from consumers who are also shareholders. Shareholders of modest means spend a substantial portion of their income on consumer goods and services, and thus, for these individuals, the negative impact of increased consumer prices may more than offset any share price gains, especially if equity ownership is small or if price increases are significant. An examination of the source of share price gains in M&A ultimately reveals a story of divergent shareholder interests and significant harms to some classes of shareholders and to society at large.

I. INTRODUCTION

It is commonly believed that the purpose of a corporation is to maximize the wealth of its shareholders.[2] This

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1 *See infra* Sections IV.A–B.

2 *See, e.g.*, Stephen M. Bainbridge, *Executive Compensation: Who Decides?*, 83 TEX. L. REV 1615, 1616 (2005) (reviewing LUCIAN BEBCHUK & JESSE FRIED, THE UNFULFILLED PROMISE OF EXECUTIVE COMPENSATION (2004)) ("The discretionary powers thus conferred on directors and officers, however, are to be directed towards a single end; namely, the maximization of shareholder wealth."); David Millon, *New Game Plan or Business as Usual? A Critique of the Team Production Model of Corporate Law*, 86 VA. L. REV. 1001, 1002–03 (2000) (arguing that rival theories of the purpose of the corporation "have made only limited headway in the legal academy, where shareholder primacy and its narrow vision of corporate management's obligations continue to predominate"); Milton Friedman, *A Friedman Doctrine—The Social Responsibility of Business Is to Increase Its*

shareholder wealth maximization norm permeates top business and law school curricula, where the future leaders of American enterprise, law, and government are routinely taught a shareholder wealth maximization approach to corporate purpose.[3] It is manifest in the practices of corporate leaders,[4] who widely assert that it is their duty to maximize shareholder wealth at the expense of other interests.[5] It is pervasive in academic literature, where scholars frequently repeat statements such as "[t]here is strong support for the idea that shareholder wealth maximization should be the primary norm underlying the governance of for-profit corporations,"[6] "lawyers have commonly assumed that the managers must conduct the institution with single-minded devotion to

Profits, N.Y. TIMES MAG., Sept. 13, 1970, at 126 ("[T]here is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits."); Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 439 (2001) ("There is no longer any serious competitor to the view that corporate law should principally strive to increase long-term shareholder value."); DARRELL WEST, THE PURPOSE OF THE CORPORATION IN BUSINESS AND LAW SCHOOL CURRICULA 10–12 (2011) (surveying professors at leading law schools who describe this view of corporate purpose as "dominant," "settled law," "take[n] as a given," and "absolutely the dominant perspective in law schools").

[3] West, *supra* note 2, at 1–2 (finding, based upon a review of law and business school curricula, that such curricula often "emphasize the goal of maximizing shareholder value, especially in law schools").

[4] STEPHEN M. BAINBRIDGE, CORPORATION LAW AND ECONOMICS 417 (2002) ("Although some claim that directors do not adhere to the shareholder wealth maximization norm, the weight of the evidence is to the contrary.").

[5] *See, e.g.*, Jacob M. Rose, *Corporate Directors and Social Responsibility: Ethics Versus Shareholder Value*, 73 J. BUS. ETHICS 319, 326–27 (2007) (finding that when seventeen directors of Fortune 200 companies faced a conflict between shareholder interests and social welfare in their capacity as a director, all directors but one justified their decisions based upon a perceived legal obligation to maximize shareholder value).

[6] Bernard S. Sharfman, *Shareholder Wealth Maximization and Its Implementation Under Corporate Law*, 66 FLA. L. REV. 389, 391 (2014).

stockholder profit,"[7] "the persistent common perception seems to be that directorial duties require placing shareholder wealth at the forefront,"[8] "that shareholder wealth maximization is not only a goal for the corporation, but in fact the only legitimate goal, has become the dominant normative theory of the corporation,"[9] and "[s]hareholder wealth maximization long has been the fundamental norm which guides U.S. corporate decisionmakers."[10]

To be sure, this norm has not gone uncontested. In the early 1930s, E. Merrick Dodd argued that corporate duties legally can and normatively ought to go beyond shareholder wealth maximization to include "a social service as well as a profit-making function."[11] In the 1980s and 90s, Robert Phillips, R. Edward Freeman, Andrew C. Wicks and their colleagues formulated stakeholder theory as a challenge to the shareholder wealth maximization norm.[12] Stakeholder theory argues that the goal of a corporation is not merely to serve shareholders, but also to advance the interests and well-being of the many stakeholders—employees, creditors, consumers, etc.—whose inputs prove vital to corporate success.[13] In 1999, Margaret M. Blair and Lynn A. Stout put forth the team production model, which provides that the corporate form exists not to promote shareholder interests above all others but to protect the "investments of all the members of the corporate

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7 E. Merrick Dodd, Jr., *For Whom Are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145, 1163 (1932).

8 J. Haskell Murray, *Choose Your Own Master: Social Enterprise, Certifications, and Benefit Corporation Statutes*, 2 AM. U. BUS. L. REV. 1, 17 (2012) (emphasis omitted).

9 Grant M. Hayden & Matthew T. Bodie, *One Share, One Vote and the False Promise of Shareholder Homogeneity*, 30 CARDOZO L. REV. 445, 492 (2008).

10 Stephen M. Bainbridge, *In Defense of the Shareholder Wealth Maximization Norm: A Reply to Professor Green*, 50 WASH. & LEE L. REV. 1423, 1423 (1993).

11 Dodd, *supra* note 7, at 1148.

12 Robert Phillips et al., *What Stakeholder Theory Is Not*, 13 BUS. ETHICS Q. 479, 481 (2003).

13 *Id.*

'team,' including shareholders, managers, rank and file employees, and possibly . . . creditors."[14] Likewise, Lyman Johnson and David Millon recently argued for pluralism in corporate purpose, making a strong case that a corporation can be formed for "any lawful purpose," not just the maximization of shareholder wealth.[15]

Yet, despite these efforts to expand conceptions of corporate purpose, the shareholder wealth maximization norm still informs much of corporate decision-making. In fact, even legal developments that at first glance seem to best embrace alternative views of the corporation in practice reinforce the perception that shareholder wealth maximization should reign supreme—at least with respect to the traditional corporation. For example, the emergence of blended corporations such as "benefit corporations," "flexible purpose corporations," and "social purpose corporations" arguably evinces a desire on the part of businesspeople and consumers for businesses to pursue both profit *and* social good.[16] Yet, by forming a separate and distinct category of corporations that aim to benefit *both* shareholders and society at large, these corporate forms in fact reinforce the notion that traditional corporations exist only to maximize the wealth of shareholders.[17]

Moreover, arguments that collapse the distinction between shareholder wealth maximization and social welfare make it easier to dismiss challenges to the shareholder wealth maximization norm. These arguments essentially contend that when directors and managers ruthlessly pursue shareholder

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[14] Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247, 253 (1999) (emphasis omitted).

[15] Lyman Johnson & David Millon, *Corporate Law After* Hobby Lobby, 70 BUS. LAW. 1, 31 (2014).

[16] Lyman Johnson, *Pluralism in Corporate Form: Corporate Law and Benefit Corps.*, 25 REGENT U. L. REV. 269, 269 (2013) (noting that the social enterprise movement has led to the proliferation of dual mission entities, as well as legal and business reform); *see also* Murray, *supra* note 8, at 3–5.

[17] Johnson, *supra* note 16, at 295 (noting the possibility that "legislation authorizing special vehicles for social enterprise—i.e., Benefit Corps.—implies that traditional corporations should maintain, if not heighten, their predominant focus on profits and shareholder wealth").

wealth maximization, they create jobs, economic growth, and technological advancements that ultimately maximize social welfare—or, in other words, that it is ultimately in the interest of shareholders to promote stakeholder interests, as good community relations, loyal employees, and loyal customers are vital to the long-term health of any company.[18] As Stephen Bainbridge states in one permutation of this argument, "For many years, the basic rule that shareholder interests come first has governed public corporations. That rule has helped produce an economy that is dominated by public corporations, which in turn has produced the highest standard of living of any society in the history of the world."[19]

Such arguments are appealing because they turn a contentious debate into a win-win situation. Corporations have their shareholder wealth maximization cake and society eats it too.

However, whether shareholder wealth maximization actually advances stakeholder welfare (and vice versa) is an empirical question that proves nearly impossible to answer. While it is easy to contemplate hypothetical situations where stakeholder and shareholder interests conflict, it is far more difficult to empirically prove or disprove the notion that, when all corporations make shareholder wealth maximization their principal goal, society is better off than they would be if all (or some) corporations sought to promote *both* social welfare and shareholder interests in tandem. Such an answer would require either a nationwide experiment or an unfathomably sophisticated economic modeling system—both of which are out of academics' grasp.

This Article attempts to answer only a small sliver of that empirical question by examining whether one decision—whether to pursue M&A—tends to benefit shareholders and society in tandem or instead tends to pit the interests of shareholders and society against each other. In so doing, this Article seeks to assess the validity of the shareholder wealth

[18] Leo E. Strine, Jr., *The Social Responsibility of Boards of Directors and Stockholders in Change of Control Transactions: Is There Any "There" There?*, 75 S. CAL. L. REV. 1169, 1172–74 (2002).

[19] Bainbridge, *supra* note 10, at 1446.

maximization norm generally and shed light on how directors, institutional investors, proxy advisors, scholars, and policymakers ought to approach the shareholder wealth maximization norm in the context of M&A specifically.

This Article begins with an analysis of the corollary assumptions subsumed in the shareholder wealth maximization norm in Part II. Part III proceeds to analyze how these assumptions have shaped theoretical understandings of M&A activity. Part IV proceeds to analyze the economic validity of these assumptions, and Part V uses economic data to promote a reexamination of the shareholder wealth maximization norm and its implications for several key corporate actors.

II. CORE ASSUMPTIONS OF THE SHAREHOLDER WEALTH MAXIMIZATION NORM

A. The Purpose of a Corporation is to Benefit Shareholders Financially

The most basic tenet of the shareholder wealth maximization norm is that the purpose of a corporation is to benefit its shareholders financially. This tenet has been expressed in subtly different forms. The name of the norm itself refers to the maximization of shareholder *wealth*. The case *Dodge v. Ford Motor Co.*, however, states this tenet in terms of stockholder *profits*:

> A business corporation is organized and carried on primarily for the *profit of the stockholders*. The powers of the directors are to be employed for that end. The discretion of directors is to be exercised in the choice of means to attain that end, and does not extend to a change in the end itself, to the reduction of profits, or to the nondistribution of profits among stockholders in order to devote them to other purposes.[20]

Milton Friedman similarly focuses on the profit of stockholders in his famous article *The Friedman Doctrine—The*

[20] *Dodge v. Ford Motor Co.*, 170 N.W. 668, 684 (Mich. 1919) (emphasis added).

Social Responsibility of Business Is to Increase Its Profits.[21] The American Law Institute's *Principles of Corporate Governance*, meanwhile, uses both the terms *corporate profit* and *shareholder gain*, stating "a corporation . . . should have as its objective the conduct of business activities with a view to enhancing *corporate profit* and *shareholder gain*."[22]

Though the terminology differs slightly, the core of the idea is that a corporation exists to benefit shareholders financially. This Article will use the term "shareholder financial benefit" to encompass the various iterations of the norm.

B. "Shareholders" Refers to Personified Stock

The pursuit of shareholder financial benefit, however, requires corporate directors to have a sense of who shareholders are and what shareholders care about financially. Indeed, those persons that own stock—whether directly or indirectly—are real, flesh-and-blood human beings, and human beings necessarily have a host of complex financial concerns. Different shareholders likely have different risk tolerance levels, divergent time horizons for achieving financial goals, varying levels of diversification, and heightened interests in the stability of the particular companies where they are employed.[23] A recent college graduate may well prefer a more aggressive financial approach than a retiree. An employee, even one who holds stock in his or her company, might care more about preventing layoffs than a small change in share price. Day-traders and long-term stock owners also likely have

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[21] *See* Friedman, *supra* note 2.

[22] PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 2.01 (AM. LAW INST. 1994) (emphasis added).

[23] Lynn A. Stout, *Why We Should Stop Teaching* Dodge v. Ford, 3 VA. L. & BUS. REV. 163, 174 (2008) ("Different shareholders have different investment time frames, different tax concerns, different attitudes toward firm-level risk due to different levels of diversification, different interests in other investments that might be affected by corporate activities, and different views about the extent to which they are willing to sacrifice corporate profits to promote broader social interests . . . .").

different financial preferences, as do very wealthy investors and working-class investors.

Despite these complexities, the shareholder wealth maximization norm does not require directors to measure the actual financial preferences of their real-world shareholders. Instead, the norm as it is generally understood permits directors to simplify their task of benefitting shareholders financially by focusing on how their activities impact a "fictional shareholder."[24] As Daniel Greenwood describes, this "fictional shareholder" is "a person with no interests other than its shareholdings in the particular corporation at issue, and no will other than the desire to maximize the value of that shareholding. It is, then, no more than a personification of a share of the particular corporation."[25] Thus, in practice, the notion of "shareholder financial benefit" means financial benefit to the fictionalized, non-diversified holders of shares in one particular company, or, more simply, the pursuit of the best possible stock performance for the shares of a given firm.

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[24] Gregory Scott Crespi, *Maximizing the Wealth of Fictional Shareholders: Which Fiction Should Directors Embrace?*, 32 J. CORP. L. 381, 383–84 (2007) (stating that the law "allows directors to greatly reduce the burden of discharging their fiduciary duties to this diverse group of shareholders by permitting them to consider only the impacts of their actions upon a generic 'fictional shareholder' abstraction"); *see also* Lawrence E. Mitchell, *The Human Corporation: Some Thoughts on Hume, Smith, and Buffett*, 19 CARDOZO L. REV. 341, 358 (1997) (referring to "the current fictionalized model of the stockholder" as a person "with the single goal of maximizing profits"); Daniel J.H. Greenwood, *Fictional Shareholders: For Whom Are Corporate Managers Trustees, Revisited*, 69 S. CAL. L. REV. 1021, 1031 (1996) (describing the notion of a shareholder as "a fictional person whose sole interest is the shares it owns").

[25] *Id.* at 1058; *see also* FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 124 (1991) (describing "[m]arket [v]alue as a [b]enchmark under the [f]iduciary [p]rinciple"); Richard A. Booth, *Stockholders, Stakeholders, and Bagholders (or How Investor Diversification Affects Fiduciary Duty)*, 53 BUS. LAW. 429, 434 (1998) ("[I]t is the undiversified stockholder—an investor who is focused on the fortunes of a single company—who is the traditional model for the hypothetical reasonable stockholder to whom management duty is owed.").

This is not to say that the conflation of shareholder interests with stock performance has gone unquestioned—the notion that stockholders are not a homogeneous group of individuals fixated on wealth maximization has gained increasing attention. Commentators have pointed to the potential for substantial deviation in shareholder financial interests, such as the aforementioned variations in risk tolerance,[26] time horizon,[27] diversification,[28] and their employment situation.[29] In so doing, they have problematized the traditionalist interpretation of the shareholder wealth maximization norm and,

[26] *See, e.g.*, Eric W. Orts, *The Complexity and Legitimacy of Corporate Law*, 50 WASH. & LEE L. REV. 1565, 1591 (1993) ("Shareholders have different time and risk preferences that managers must somehow factor together, if they are to represent fairly the artificially unified interest of 'the shareholders' in general."); Henry T.C. Hu, *Risk, Time, and Fiduciary Principles in Corporate Investment*, 38 UCLA L. REV. 277, 287 (1990) ("Each shareholder has unique risk preferences . . . ."); Iman Anabtawi, *Some Skepticism About Increasing Shareholder Power*, 53 UCLA L. REV. 561, 586 (2006) (comparing the risk tolerance of inside and outside shareholders).

[27] *See, e.g.*, Stephen M. Bainbridge, *The Board of Directors as Nexus of Contracts*, 88 IOWA L. REV. 1, 21 (2002) (noting that shareholders have divergent time horizons); Leo E. Strine, Jr., *Who Bleeds When the Wolves Bite?: A Flesh-and-Blood Perspective on Hedge Fund Activism and Our Strange Corporate Governance System*, 126 YALE L.J. 1870, 1884–85 (2017) (noting that human investors have a longer time horizon for their investments); John C. Coffee, Jr. & Darius Palia, *The Wolf at the Door: The Impact of Hedge Fund Activism on Corporate Governance*, 41 J. CORP. L. 545, 573 (2016) (remarking that the typical hedge fund investor has a shorter time horizon than other groups of investors); Orts, *supra* note 26, at 1591 (remarking on divergent time preferences as an obstacle for corporate managers who seek to pursue shareholder interests uniformly).

[28] *See, e.g.*, Stout, *supra* note 23, at 174 (noting that different shareholders have different interests due in part to variances in their level of diversification); JAMES P. HAWLEY & ANDREW T. WILLIAMS, THE RISE OF FIDUCIARY CAPITALISM 21 (2000) (noting the unique interests of highly diversified "universal owner[s]"); Hayden & Bodie, *supra* note 9, at 493 ("[S]hareholders with a diversified portfolio have different interests than shareholders with most of their wealth tied up in one company.").

[29] *See, e.g.,* Strine, *supra* note 27, at 1876–77 (noting that jobs, not stock performance, drive wealth creation for all but the very rich); Anabtawi, *supra* note 26, at 586 (comparing the interests of employee-stockholders and non-employee-stockholders).

in particular, the presumed focus on stock performance as a proxy for true financial benefit.

Despite this attention to the variation in stockholders' characteristics,[30] corporate law theorists have stressed the abstraction of a homogenous shareholder personified by the shares themselves as a necessary assumption of the model, as it enables directors to make coherent decisions and prevents them from using potential discrepancies in shareholder interests to justify acts actually taken in pursuit of personal gain.[31] Scholars have further argued that stock performance is the ideal metric because "it is the only judgment that cannot be manipulated, at least not for long," implying that other substitutes for stock performance are thereby inferior.[32]

Commentators have also argued that potential deviations in shareholder financial preferences are inconsequential. For instance, scholars have dismissed concerns related to shareholders' different time horizons by theorizing that share price reflects the present value of projected future prices and that, thus, there is no true conflict between shareholders interested in short-term stock performance and those interested in long-term stock performance.[33] Likewise, scholars have dismissed concerns related to shareholders' various risk preferences by postulating that so long as a corporation seeks to maximize stock performance in its pursuit of risk, risk-tolerant stockholders will benefit from risky endeavors that match their

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[30] Paul H. Edelman & Randall S. Thomas, *Corporate Voting and the Takeover Debate*, 58 VAND. L. REV. 453, 464 (2005) (noting that models by Lucian Bebchuck, Oliver Hart, Ronald Gilson, and Alan Schwartz "make unrealistic assumptions about the homogeneity of shareholders, both in the size of their holdings and in their voting behavior. [The models] also ignore differences in the signal to which the shareholders listen.").

[31] Bainbridge, *supra* note 10, at 1445.

[32] ROBERT A.G. MONKS & NELL MINNOW, CORPORATE GOVERNANCE 67 (3d ed. 2004).

[33] Michael C. Jensen, *Value Maximization, Stakeholder Theory, and the Corporate Objective Function*, 12 BUS. ETHICS Q. 235, 241 (2002); *see also* George W. Dent, Jr., *Stakeholder Governance: A Bad Idea Getting Worse*, 58 CASE W. RES. L. REV. 1107, 1109–11 (2008) (denying that a problem with short-termism exists).

own risk preferences, and risk-averse stockholders can sell their stocks at an increased price to avoid the risk.[34] Scholars have alternatively dismissed these concerns by arguing that differences in risk preferences can be ignored because risk-averse investors have better (and cheaper) methods to mitigate risk, such as diversification and investment in low-risk instruments, than relying on corporate boards to mitigate risk for them.[35] Finally, scholars have dismissed concerns related to the special interests of employee-stockholders by maintaining that widespread adherence to the shareholder wealth maximization norm will yield better salaries, opportunities, and working conditions for all employees.[36] Such a rebuttal implies that even employee-stockholders are better with the shareholder wealth maximization norm than without it.[37]

Moreover, while it is easy to hypothesize about potential conflicts between subgroups of shareholders or to point to anecdotal examples of such conflicts, it is more difficult to establish empirically that such conflicts exist, which facilitates the dismissal of such concerns. These concerns become a question of proof, and it is difficult to prove that, for instance, risk-averse shareholders would be better off financially if directors incorporated their risk preferences into corporate decision-making, or that shareholders who prefer short-term gains would benefit financially if directors incorporated that preference into their business strategies. Because answering these questions requires reliance on counterfactuals, it is hard to find convincing evidence that shareholders with divergent interests do not uniformly benefit from director adherence to the shareholder wealth maximization norm as measured by stock performance. Ultimately, despite numerous critiques, reliance

[34] Hu, *supra* note 26, at 289–90.

[35] EASTERBROOK & FISCHEL, *supra* note 25, at 29.

[36] Mark J. Roe, *The Shareholder Wealth Maximization Norm and Industrial Organization*, 149 U. PA. L. REV. 2063, 2065 (2001).

[37] *Id.*

on stock performance as a measure of a shareholder's financial well-being remains commonplace.[38]

C. Shareholder Wealth Maximization Benefits Society as a Whole

A third component of the shareholder wealth maximization norm is the assumption that adherence to the norm simultaneously benefits the corporation's shareholders, the corporation's stakeholders, and, more generally, society as a whole. In its simplest form, this argument provides that if an enterprise's business operations prosper, then so too will the rest of society, which stands to gain from a "stronger corporate economy and brighter economic future."[39] A second variation of this argument asserts that an exclusive focus on profit maximization prevents directors from using societal welfare as a way to disguise acts taken primarily out of self-interest.[40] And a third variation of this argument stresses that profit maximization provides society at large with a mechanism for identifying and pursuing the most beneficial result when making tradeoff decisions.[41] Regardless of the exact contours of this argument, the core of the idea remains the same: the profit maximization norm provides the optimal results for shareholders, stakeholders, and society.

This assumption entails a less obvious corollary: corporate law scholars use profit maximization as a vehicle to normatively assess the legitimacy or desirability of various corporate

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[38] MICHAEL USEEM, EXECUTIVE DEFENSE: SHAREHOLDER POWER AND CORPORATE REORGANIZATION 8–11 (1993).

[39] Charles M. Elson & Nicholas J. Goossen, *E. Merrick Dodd and the Rise and Fall of Corporate Stakeholder Theory*, 72 BUS. LAW. 735, 754 (2017); *see also* Martin Lipton & Steven A. Rosenblum, *A New System of Corporate Governance: The Quinquennial Election of Directors*, 58 U. CHI. L. REV. 187, 227–28 (1991).

[40] *See, e.g.*, Bainbridge, *supra* note 10, at 1445; Bernard S. Black, *Agents Watching Agents: The Promise of Institutional Investor Voice*, 39 UCLA L. REV. 811, 821 (1992).

[41] Jensen, *supra* note 33, at 241.

law policies.[42] These scholars justify or militate against a given policy because of its effect on shareholder value.[43] In so doing, they imply that policymakers and directors share the same goal—maximizing shareholder value—rather than establishing whether and to what extent maximizing shareholder value promotes commonly-held goals such as advancing social welfare. This conflation of goals is justifiable only when presuming that shareholder wealth maximization serves as a sufficient proxy for social welfare.

III. THE SHAREHOLDER WEALTH MAXIMIZATION NORM AND M&A ACTIVITY: THEORETICAL PERSPECTIVES

The aforementioned components of the shareholder wealth maximization norm—and, in particular, the twin assumptions that (1) the purpose of a corporation is to benefit shareholders financially and (2) financial benefit is measured through stock performance—have shaped the lens through which corporate law scholars view M&A activity. Indeed, pursuant to the shareholder wealth maximization norm, activities that enrich shareholders are deemed proper. Thus, the norm requires that if M&A activity increases shareholder wealth, then such activity necessarily ought to be pursued.

The focus on shareholder wealth as the proper measure of the desirability of M&A activity can be seen throughout the

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42 *See, e.g.*, Michael Abramowicz, *Speeding Up the Crawl to the Top*, 20 YALE J. ON REG. 139, 146 (2003).

43 *See, e.g.*, Lucian Arye Bebchuk, *The Case Against Board Veto in Corporate Takeovers*, 69 U. CHI. L. REV. 973, 989 (2002) (focusing on the impact of board veto on various shareholder returns); Lucian Arye Bebchuk et al., *The Powerful Antitakeover Force of Staggered Boards: Theory, Evidence, and Policy*, 54 STAN. L. REV. 887, 939 (2002) (noting the effect of classified boards on shareholder returns); Robert Comment & G. William Schwert, *Poison or Placebo? Evidence on the Deterrence and Wealth Effects of Modern Antitakeover Measures*, 39 J. FIN. ECON. 3, 7–8 (1995) (discussing studies that assess the wealth effects of antitakeover provisions); *see also infra* notes 47, 49.

literature on the topic.[44] In the context of negotiated merger deals, scholars have argued that deal protection devices, such as voting agreements, lockups, and defensive tactics, are desirable because they benefit shareholders through increased returns and that these same devices are detrimental because they harm shareholders by reducing returns.[45] In the context of hostile takeovers, scholars have vigorously debated the value of takeover defenses by assessing whether these devices benefit or harm shareholders, using various measures of shareholder wealth as their criterion.[46] Numerous others have argued that various types of M&A are beneficial or

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44 Robert T. Miller, *Inefficient Results in the Market for Corporate Control: Highest Bidders, Highest-Value Users, and Socially Optimal Owners*, 39 J. CORP. L. 71, 73–74 (2013).

45 *See, e.g.*, Frank H. Easterbrook & Daniel R. Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161, 1164 (1981) (arguing that shareholders' welfare is maximized where the sum of "the price that will prevail in the market if there is no successful offer (multiplied by the likelihood that there will be none) and the price that will be paid in a future tender offer (multiplied by the likelihood that some offer will succeed)" is also maximized); Fernán Restrepo & Guhan Subramanian, *The New Look of Deal Protection*, 69 STAN. L. REV. 1013, 1018 (2017) (arguing that "allocational efficiency . . . requires a balance" in order to best promote shareholder returns); Ian Ayres, *Analyzing Stock Lock-Ups: Do Target Treasury Sales Foreclose or Facilitate Takeover Auctions?*, 90 COLUM. L. REV. 682, 713 (1990) (noting that target shareholders may gain financially through stock lockups); Thanos Panagopoulos, *Thinking Inside the Box: Analyzing Judicial Scrutiny of Deal Protection Devices in Delaware*, 3 BERKLEY BUS. L.J. 437, 439–40 (2006) (assessing whether deal protection devices create value for the buyers and sellers in a transaction); Matthew T. Bodie, *Workers, Information, and Corporate Combinations: The Case for Nonbinding Employee Referenda in Transformative Transactions*, 85 WASH. U. L. REV. 871, 881 (2007) ("[T]he corporation's organizing principle should be the maximization of the residual returns payable to shareholders.").

46 *See, e.g.*, Bebchuk, *supra* note 43, at 989 (focusing on the impact of board veto on shareholder returns); Bebchuk et al., *supra* note 43, at 939 (noting the effect of classified boards on shareholder returns); Comment & Schwert, *supra* note 43, at 23–24 (collecting studies that assess the effects of antitakeover provisions).

harmful by appealing to their effect on wealth for the shareholders of the target and/or the acquirer.[47]

Of course, the desirability of M&A activity is not a settled matter and remains a considerable source of debate. In recent years, much of this debate has focused on whether shareholders or directors should serve as the decision makers charged with determining whether a given merger will enrich shareholders.[48] This debate thus serves as a platform for the sparring director primacy advocates and shareholder primacy advocates to make their cases. On one side of the debate, shareholder primacy scholars argue that empowering shareholders to make decisions regarding takeovers promotes improved corporate governance. Ex-ante, shareholder empowerment is thought to motivate directors to improve performance for fear of a corrective response by shareholders in the event

[47] *See, e.g.*, Frank H. Easterbrook & Daniel R. Fischel, *Takeover Bids, Defensive Tactics, and Shareholders' Welfare*, 36 BUS. LAW. 1733, 1737–39 (1981) (assessing the financial impact of defensive tactics); Frank H. Easterbrook & Gregg A. Jarrell, *Do Targets Gain from Defeating Tender Offers?*, 59 N.Y.U. L. REV. 277, 280–81 (1984) (looking at returns following successful and defeated tender offers); Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 604 n.282 (2003) (citing data on shareholder returns to demonstrate that shareholders benefit financially from M&A activity); Gregg A. Jarrell et al., *The Market for Corporate Control: The Empirical Evidence Since 1980*, 2 J. ECON. PERSP. 49, 51–53 (1988) (summarizing empirical data on returns to bidders and targets); Michael C. Jensen & Richard S. Ruback, *The Market for Corporate Control: The Scientific Evidence*, 11 J. FIN. ECON. 5, 47 (1983) (finding that corporate takeovers generate positive gains that benefit target shareholders and do not harm bidding shareholders); Michael Bradley, *Interfirm Tender Offers and the Market for Corporate Contro*l, 53 J. BUS. 345, 347 (1980) ("[T]he underlying synergy [from tender offer deals] is presumed to have a value-increasing effect on the shares of both firms."); MARK L. SIROWER, THE SYNERGY TRAP: HOW COMPANIES LOSE THE ACQUISITION GAME (1997) (analyzing empirical evidence and finding that bidders earn little or slightly negative average returns on acquisitions).

[48] Luca Enriques et al., *The Case for an Unbiased Takeover Law (with an Application to the European Union)*, 4 HARV. BUS. L. REV. 85, 86–87 (2014); *see also* William T. Allen et al., *The Great Takeover Debate: A Meditation on Bridging the Conceptual Divide*, 69 U. CHI. L. REV. 1067, 1071, 1074–77 (2002).

of poor performance.[49] Ex-post, shareholder empowerment arguably improves corporate performance by providing a mechanism to replace underperforming directors with superior directors.[50] On the other side of the debate, director primacy scholars contend that directors have better information than shareholders as to whether or not a given merger will promote shareholder value[51] and that directors will promote the long-term interest of shareholders better than shareholders themselves, who may myopically focus on short-term gains to the detriment of long-term growth and investment.[52]

Note, however, that the nexus of this shareholder-director primacy debate centers on *who* should decide whether a given merger promotes shareholder value,[53] and not whether M&A activity that results in increased shareholder wealth should be pursued, which is a generally accepted premise on both sides of the debate.[54] Indeed, those who advocate for shareholders as merger decision makers, such as Professors Lucian Bebchuk, John C. Coates IV, and Guhan Subramanian, frequently use evidence of positive shareholder returns to justify shareholder empowerment and evidence of negative shareholder returns to criticize pro-board provisions.[55] Even those

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[49] EASTERBROOK & FISCHEL, *supra* note 25, at 162–71.

[50] Luca Enriques et al., *supra* note 48, at 86.

[51] *See, e.g.*, Stephen M. Bainbridge, Response, *Director Primacy in Corporate Takeovers: Preliminary Reflections*, 55 STAN. L. REV. 791, 799–800 (2002) (noting that the board of directors has superior access to information than other constituencies).

[52] *See, e.g.*, Martin Lipton, *Corporate Governance in the Age of Finance Corporatism*, 136 U. PA. L. REV. 1, 5–6 (1987) (noting that institutional investors' short-termism resulted in a detrimental surge of takeovers that harm shareholders themselves and the larger economy).

[53] Bainbridge, *supra* note 47, at 605.

[54] *See, e.g.*, *id.* at 550 ("[T]he director primacy theory embraces the shareholder wealth maximization norm. . . .").

[55] *See, e.g.*, Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 853 (2005) (citing evidence that a staggered board "considerably reduces the returns to the target's shareholders both in the short-run and in the long-run"); Lucian Bebchuk et al., *What Matters in Corporate Governance?*, 39 (John M. Olin Ctr. for Law, Econ. & Bus., Discussion Paper No. 491, 2004) (finding that "entrenching provisions"

who believe that directors are the proper decision makers seek to legitimize the board's role in merger decision-making by citing both directors' willingness to pursue mergers that generate gains for stockholders and the beneficial effects of pro-board provisions on stockholder returns.[56] On both sides of the debate, then, scholars are united in the belief that, whoever the appropriate decision maker may be, that decision maker ought to pursue M&A that increases shareholder wealth.

To be sure, some scholars have argued that a proper analysis of M&A activity should extend beyond a narrow focus on shareholder wealth. One common criticism is that M&A activity imposes substantial costs on managers, creditors, employees, customers, suppliers, and local communities and that these costs should be factored into assessments of merger desirability.[57] A related criticism argues that directors should consider stakeholder interests when deciding whether to pursue mergers.[58] Such arguments beg the question of whether

correlated negatively with stock returns from 1990–2003); Bebchuk et al., *supra* note 43, at 891 (arguing that staggered boards reduce shareholder returns).

[56] *See, e.g.*, Stephen M. Bainbridge, Unocal *at 20: Director Primacy in Corporate Takeovers*, 31 DEL. J. CORP. L. 769, 820 (2006); Martin Lipton & Paul K. Rowe, Response, *Pills, Polls and Professors: A Reply to Professor Gilson*, 27 DEL. J. CORP. L. 1, 21 (2002) (citing evidence that pills increase shareholder returns).

[57] Strine, *supra* note 27, at 1945–47; *see also* Alexander C. Gavis, *A Framework for Satisfying Corporate Directors' Responsibilities Under State Nonshareholder Constituency Statutes: The Use of Explicit Contracts*, 138 U. PA. L. REV. 1451, 1453 (1990).

[58] *See, e.g.*, Blair & Stout, *supra* note 14, at 304–05 (applying the mediating hierarchy model to director decision-making); John C. Coffee, Jr., *The Uncertain Case for Takeover Reform: An Essay on Stockholders, Stakeholders and Bust-Ups*, 1988 WIS. L. REV. 435 (1988) (arguing for the consideration of stakeholder interests when evaluating takeovers); PETER O. STEINER, MERGERS: MOTIVES, EFFECTS, POLICIES 47–74 (1975) (indicating that synergy gains can come from the cost reductions involved in combining two businesses); Joseph F. Brodley, *Antitrust Standing in Private Merger Cases: Reconciling Private Incentives and Public Enforcement Goals*, 94 MICH. L. REV. 1, 88 (1995) (noting that collusive mergers can harm stakeholder groups).

shareholder wealth maximization in the context of M&A deals comes at the cost of broader societal welfare.

Proponents of the shareholder wealth maximization norm are not indifferent to the source of financial gains to shareholders, and many justifications exist for how shareholder gains from M&A activity translate to increased societal welfare. Merger gains are often attributed to the efficiency gains that come from displacing inefficient incumbent managers[59] or to the synergistic gains from eliminating redundancies.[60] Merger gains have also been explained by the "integration of production [and] more effective use of information," both of which have a beneficial effect on society overall.[61] These justifications, coupled with arguments that M&A activity provides net benefits to both shareholders and society, have led scholars to conclude that negative externalities arising from M&A activity do not render those M&A activities undesirable.[62]

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[59] *See e.g.*, Easterbrook & Fischel, *supra* note 45, at 1184 ("Society benefits from an active takeover market, therefore, because it simultaneously provides an incentive to all corporate managers to operate efficiently and a mechanism for displacing inefficient managers."); Ronald J. Gilson, *A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers*, 33 STAN. L. REV. 819, 838–39 (1981) (noting that replacing inefficient management can yield gains); Marcel Kahan & Michael Klausner, *Lockups and the Market for Corporate Control*, 48 STAN. L. REV. 1539, 1542 (1996) (stating that the replacement of inefficient management through M&A activity "can increase the value of a company by moving its assets to a more efficient management team").

[60] *See, e.g.*, Stephen M. Bainbridge, *Interpreting Nonshareholder Constituency Statutes*, 19 PEPP. L. REV. 971, 1009 (1992) (citing "synergistic gains" as a "fairly standard explanation" for takeover gains); Michael C. Jensen, *Agency Costs of Free Cash Flow, Corporate Finance, and Takeovers*, 76 AM. ECON. REV. 323, 327 (1986) (noting that efficiency gains stemmed from certain takeovers in the oil industry); Jensen & Ruback, *supra* note 47, at 9 ("[T]akeover gains apparently come from the realization of increased efficiencies or synergies, but the evidence is not sufficient to identify their exact sources").

[61] Frank H. Easterbrook & Daniel R. Fischel, *Auctions and Sunk Costs in Tender Offers*, 35 STAN. L. REV. 1, 1 (1982).

[62] *See, e.g.*, Lucian Arye Bebchuk, *Toward Undistorted Choice and Equal Treatment in Corporate Takeovers*, 98 HARV. L. REV. 1693, 1696

Since Henry G. Manne's seminal paper in 1965, *Mergers and the Market for Corporate Control*, it has been commonly accepted that the ways in which mergers might increase the value of the merging parties fall into one of two categories. The first involves efficiencies promoted by the market for corporate control, in which mergers provide an important route for resources to flow to their highest-valued use.[63] The second involves diminished competition,[64] which would increase the market power of the merged entity and enable the merged entity to raise its prices, thereby enriching its shareholders.[65]

To the extent that merger gains accrue through the first route, social welfare and shareholder wealth maximization are not at odds, but are, in fact, complementary. Synergistic efficiencies benefit consumers by improving the production and distribution of goods and services, while a vigorous market for corporate control is thought to motivate managers to engage in more efficient practices or to yield a change in management when firms are being run suboptimally.[66] This first route benefits society in numerous ways, including the "lessening of wasteful bankruptcy proceedings, more efficient management of corporations, the protection afforded non-controlling corporate investors, increased mobility of capital, and generally a more efficient allocation of resources."[67]

To the extent that merger gains accrue through the second route, however, increased shareholder wealth comes at the expense of social welfare. Market power influences the degree to

(1985) (implying that an efficient takeover market ultimately fosters social welfare by promoting the efficient allocation of corporate assets); Easterbrook & Fischel, *supra* note 45, at 1174 (arguing that "takeovers are beneficial to both shareholders and society").

[63] Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110, 112 (1965).

[64] *Id.* at 120.

[65] Fred S. McChesney, *Manne, Mergers, and the Market for Corporate Control*, 50 CASE W. RES. L. REV. 245, 248 (1999).

[66] Peter C. Carstensen, *The* Philadelphia National Bank *Presumption: Merger Analysis in an Unpredictable World*, 80 ANTITRUST L.J. 219, 252 (2015).

[67] Manne, *supra* note 63, at 119.

which firms can increase markups on their products.[68] This can be profitable for the firm, but it also imposes costs on consumers.[69] In fact, gains in market power can work as a powerful mechanism for transferring wealth from the poor and working class to equity investors and other wealthy citizens by turning "the disposable income of the many into capital gains, dividends, and executive compensation for the few."[70] Moreover, increased market power can also harm workers, since the firm faces less pressure from competitors to raise wages or provide better working conditions for its employees.[71] In this way, increased market power may yield employment and wage levels below the socially optimal level.[72]

Problematically, increased market power is not likely to be a temporary result from M&A activity, as firms benefitting from market power tend to invest in preserving their market position by increasing barriers to entry in the market and by opposing efforts to increase competition.[73] In this way, increased market power functions as a long-term harm involving a sustained period of higher prices and decreased competition in a given industry.

Judges, academics, and practitioners often share a general belief that a merger is a desirable event, likely to benefit

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[68] Guy Rolnik & Asher Schechter, *Do Mergers Benefit or Harm the Economy? Q&A with Bruce Blonigen*, PROMARKET (Dec. 23, 2016), https://promarket.org/do-mergers-harm-economy-qa-with-bruce-blonigen [perma.cc/C3V5-4EFY].

[69] A. Douglas Melamed, Response, *Antitrust Law Is Not That Complicated*, 130 HARV. L. REV. F. 163, 166–67 (2017) ("[M]arket power is costly. It generally means higher prices and reduced output and often means diminished incentive to engage aggressively in welfare-enhancing conduct.").

[70] Lina Khan & Sandeep Vaheesan, *Market Power and Inequality: The Antitrust Counterrevolution and Its Discontents*, 11 HARV. L. & POL'Y REV. 235, 236 (2017).

[71] COUNCIL OF ECON. ADVISORS, BENEFITS OF COMPETITION AND INDICATORS OF MARKET POWER 2 (2016), https://obamawhitehouse.archives.gov/sites/default/files/page/files/20160414_cea_competition_issue_brief.pdf [perma.cc/7W45-G64D].

[72] *Id.*

[73] Carstensen, *supra* note 66, at 251.

shareholders via efficiency gains and unlikely to result in harmful increases in market power.[74] This presumption results at least in part from the scholarship of Robert Bork. In his book *The Antitrust Paradox*, Bork argued that the typical horizontal merger would not harm consumers.[75] His essential premise was that mergers that allow at least three large entities to remain in an industry would be unlikely to result in any harm to competition.[76] His theories, along with Chicago School precepts corroborating that mergers typically have benign or beneficial effects on competition, have shaped philosophical and practical approaches to mergers in recent years.[77] However, such arguments are increasingly subject to challenge on empirical grounds.[78]

Of course, to those who embrace the twin assumptions that (1) the purpose of the corporation is to benefit shareholders financially, and (2) benefit to shareholders is measured through stock performance, the source of increased shareholder gains may be inconsequential. Indeed, the shareholder wealth maximization norm obligates corporate managers to maximize shareholders' wealth, even when those gains come at the expense of other stakeholders and society as a whole.[79]

A broader understanding of shareholder benefits changes the analysis. Shareholders are not merely fictional beings with a financial interest in the performance of a single company, but flesh-and-blood-humans. These "human investors," to use Chief Justice Leo Strine's term, care not only about the performance of a single stock, but likely have a substantial, and more acute, financial interest in the performance of their

[74] *Id.* at 252.

[75] Orley Ashenfelter et al., *Did Robert Bork Understate the Competitive Impact of Mergers? Evidence from Consummated Mergers*, 57 J. L. & ECON. S67, S95–96 (2014).

[76] *Id.* at S96.

[77] Khan & Vaheesan, *supra* note 70, at 270–71.

[78] Christopher R. Leslie, *Antitrust Made (Too) Simple*, 79 ANTITRUST L.J. 917, 921–26 (2014).

[79] Joel Slawotsky, *The Virtues of Shareholder Value Driven Activism: Avoiding Governance Pitfalls*, 12 HASTINGS BUS. L.J. 521, 521 (2016).

diversified retirement portfolio, the stability of their employment, the performance of the overall economy, and, relevant to present purposes, the prices they must pay for goods.[80] To human investors, it matters a great deal whether the gains that come from M&A activity accrue at the expense of the American consumer and the American economy or, rather, whether merger gains and economic growth occur in tandem.

For investors such as these, understanding the *source* of merger gains provides important insight into the utility of stock price as a measure of shareholder financial benefit. Indeed, if the gain to share price is offset by a loss to shareholders due to price increases, the utility of the limited conception of shareholder wealth maximization is called into question. More broadly, for those who support shareholder wealth maximization on the grounds that adherence to the norm yields increased societal welfare, it also matters a great deal whether merger gains come at the expense of or in conjunction with social welfare. If merger gains accrue primarily through market power-induced price increases rather than efficiency gains, then using shareholder wealth maximization as a method of increasing social welfare is suspect.

Given these considerations, it is critical to determine whether and to what extent M&A activity generates efficiency gains rather than market power increases. Such information can demonstrate (1) whether M&A activity benefits shareholders beyond the mere performance of one single stock and (2) whether M&A activity serves society as a whole. Thus, this Article will now analyze whether returns from M&A activity result from efficiency gains or increases in market power.

IV. A SUMMARY OF ECONOMIC RESEARCH ON THE SOURCE OF MERGER GAINS

The source of gains from M&A activity is an important and controversial subject. As mentioned above, there are two main channels through which M&A activity may enhance

[80] *See* Strine, *supra* note 27, at 1945.

profitability: (1) increased efficiency or (2) increased market power.[81] Traditionally, when one company acquires or merges with another, management highlights purported efficiency gains as a means to justify the merger.[82] Efficiency gains, sometimes referred to as productivity or "synergy" gains, may encompass a wide variety of corporate activities, such as implementing a more effective corporate strategy, eliminating duplicative employees, or closing underperforming plants.[83] Efficiency gains have the beneficial social effect of lowering prices for consumers.[84] Thus, increases in efficiency mean that consumers will pay less for the same good or service than before the merger. Although efficiency gains are sometimes controversial—especially those that involve job losses—

81 Bruce A. Blonigen & Justin R. Pierce, *Evidence for the Effects of Mergers on Market Power and Efficiency* 2 (Nat'l Bureau of Econ. Res., Working Paper No. 22750, 2016), http://www.nber.org/papers/w22750.pdf [perma.cc/6H2L-9VBT].

82 *See, e.g.*, *Marriott International to Acquire Starwood Hotels & Resorts Worldwide, Creating the World's Largest Hotel Company*, MARRIOTT NEWS CTR. (Nov. 16, 2015), http://news.marriott.com/2015/11/marriott-international-to-acquire-starwood-hotels-resorts-worldwide-creating-the-worlds-largest-hotel-company/ [perma.cc/SB5Z-CVBA] (noting that the transaction would "unlock additional value for Marriott and Starwood shareholders" by, among other things, "leveraging operating and G&A efficiencies"); *Knight Transportation and Swift Transportation Announce All Stock Transaction with a Combined Enterprise Value of $6 Billion*, BUS. WIRE (Apr. 10, 2017, 7:00 AM), http://www.businesswire.com/news/home/20170410005557/en/Knight-Transportation-Swift-Transportation-Announce-Stock-Transaction [perma.cc/U43Y-G6BR] ("Indeed, by coming together under common ownership, the companies will be able to capitalize on economies of scale to achieve substantial synergies."); *Tesla and SolarCity to Combine*, TESLA (Aug. 1, 2016), https://www.tesla.com/blog/tesla-and-solarcity-combine [perma.cc/G82D-Z3TG] ("We expect to achieve cost synergies of $150 million in the first full year after closing. We also expect to save customers money by lowering hardware costs, reducing installation costs, improving our manufacturing efficiency and reducing our customer acquisition costs.").

83 Strine, *supra* note 27, at 1945.

84 Dario Focarelli & Fabio Panetta, *Are Mergers Beneficial to Consumers? Evidence from the Market for Bank Deposits*, 93 AM. ECON. REV. 1152, 1152 (2003).

economists generally believe that increases in efficiency and productivity, in the aggregate, have positive effects on the overall economy.[85]

Gains from increased market power present a different situation. When two competing firms merge, the resulting firm's market power may increase—that is, the firm may now face decreased competitive pressures. Market power influences "how much firms can mark up their prices above marginal cost."[86] As market power increases, firms can charge higher prices for their products. This can be profitable for the firm, but it imposes costs on consumers. Increases in market power may mean that consumers will pay more for the same good or service than before the merger. Because these costs to consumers can be shown to exceed the extra profits to the firm—generating what economists refer to as "deadweight loss"—the process reduces overall social welfare.[87] Thus, when merged firms utilize their increased market power to increase the price of their products, this results in a net loss both to consumers and to society overall.

Efficiency gains and market power gains are not mutually exclusive; an individual merger may increase both market power and efficiency for the new, larger company. In order to determine the impact of the merger on consumers, it is necessary to determine the relative magnitude of each effect. If the merger produces greater efficiency gains than market power gains, the merger will lower costs and benefit consumers.[88] However, if the market power gains outweigh the efficiency gains, the merger will raise costs and harm consumers.[89]

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[85] *See, e.g.*, STEPHEN PALMER & DAVID J. TORGERSON, ECONOMIC NOTES: DEFINITIONS OF EFFICIENCY, 318 BRIT. MED. J. 1136, 1136 (1999) (stating "Economists argue that the achievement of (greater) efficiency from scarce resources should be a major criterion for priority setting").

[86] Rolnik & Schechter, *supra* note 68.

[87] Lars-Hendrik Röller et al., *Efficiency Gains from Mergers,* in EUROPEAN MERGER CONTROL: DO WE NEED AN EFFICIENCY DEFENCE? 98 (Fabienne Ilzkovitz & Roderick Meiklejohn, eds., 2006).

[88] Focarelli & Panetta, *supra* note 84, at 1152.

[89] *Id.*

Aggregating the effects of many individual mergers and acquisitions provides insight to the overall social and economic impact of M&A activity.

A. Identifying the Source of Merger Gains: The Problem with Case Study Data

Many scholars have examined the source of gains produced by M&A activity in the economics literature. However, such studies have historically had a number of important limitations. Because of difficulty acquiring the necessary data, scholars have typically taken a case study approach, examining at most a few mergers within the same or comparable industries.[90] Due to the nature of this approach, such studies are often very limited in scope.[91] Case studies tend to be less representative of M&A transactions generally due to selection bias or the tendency to disproportionately study the most prominent and newsworthy mergers.[92] Although some studies have gone beyond the case study approach, they are generally confined to only one out of a small handful of industries—for instance, airlines, banking, hospitals, and petroleum.[93]

These studies produce mixed results, some suggesting that efficiency gains outweigh market power gains and some suggesting the opposite. Results appear to vary considerably according to market composition, industry, and geographic location, a fact that further calls into question the utility of the case study approach.[94] One review of the literature suggested

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[90] Ashenfelter et al., *supra* note 75, at S77.

[91] *See, e.g.*, Orley C. Ashenfelter et al., *Efficiencies Brewed: Pricing and Consolidation in the US Beer Industry*, 46 RAND J. ECON. 328 (2015) (examining the merger between Miller and Coors); Denis A. Breen, *The Union Pacific/Southern Pacific Rail Merger: A Retrospective on Merger Benefits*, 3 REV. NETWORK ECON. 283 (2004) (examining a large railroad merger).

[92] Blonigen & Pierce, *supra* note 81, at 5.

[93] Ashenfelter et al., *supra* note 75, at S77.

[94] Further complicating the issue, scholars have posited detrimental market power effects from bank mergers, such as reductions in cost efficiency, that are even more damaging than price increases and that are infrequently measured in traditional studies. *See* Allen N. Berger & Timothy

that efficiency gains predominated in North American and European bank mergers.[95] In contrast, a study of Asian bank mergers found no observable efficiency effects.[96] Studies of railroad industry mergers are also mixed, but may show evidence of net efficiency gains.[97] In the electric power industry, evidence suggests there are no net efficiency gains from M&A.[98] Economists John Kwoka and Michael Pollitt summarize the ongoing controversy as follows:

> Despite their importance, the effects of mergers remain in dispute. Advocates allude to the 'market for corporate control,' which views mergers and acquisitions as methods for efficiency-enhancing transfers of underperforming assets to firms that can utilize those assets better and thereby realize the value gain. Skeptics note that while many mergers may be benign or beneficial, others are motivated by market power, hubris, or simple mistakes, all of which result in societal

H. Hannan, *The Efficiency Cost of Market Power in the Banking Industry: A Test of the "Quiet Life" and Related Hypotheses*, 80 REV. ECON. & STAT. 454, 455 (1998).

95 Robert DeYoung et al., *Mergers and Acquisitions of Financial Institutions: A Review of the Post-2000 Literature*, 36 J. FIN. SERV. REV. 87 (2009).

96 Sue-Fung Wang et al., *The Long-Run Performance of Asian Commercial Bank Mergers and Acquisition*, 5 MOD. ECON. 341, 341 (2014) ("We find the Asian acquiring banks experience negative long-term abnormal returns and are not efficiency improving . . . . In general, the long-run stock performance and operating performance of Asian commercial bank merger[s] . . . cannot create synergy in the long run.").

97 *See, e.g.*, Breen, *supra* note 91, at 25 (finding dominant efficiency gains in one large railroad merger); John D. Bitzan & Wesley W. Wilson, *Industry Costs and Consolidation: Efficiency Gains and Mergers in the U.S. Railroad Industry*, 30 REV. INDUS. ORG. 81 (2007) (finding efficiency gains in railroad mergers generally); Clifford Winston et al., *Long-Run Effects of Mergers: The Case of U.S. Western Railroads*, 54 J.L. & ECON. 275 (2011) (finding negligible effects on consumer welfare). *But see* Huey-Lian Sun & Alex P. Tang, *The Sources of Railroad Merger Gains: Evidence from Stock Price Reaction and Operating Performance*, 39 TRANSP. J. 14, 25 (2000) (finding that market power effects predominate).

98 *See* John Kwoka & Michael Pollitt, *Do Mergers Improve Efficiency? Evidence from Restructuring the US Electric Power Sector*, 28 INT'L J. INDUS. ORG. 645, 646 (2010).

> costs. Evidence exists supporting each view. Stock market event studies routinely find shareholder gains from mergers, at least in the short term, seemingly corroborating the efficient-merger hypothesis. Studies of actual operating effects, on the other hand, more often tend to show that gains from merger are the exception rather than the rule.[99]

Although industry-specific and case study evidence on whether these gains come from improvements in actual operating efficiency is somewhat mixed, the evidence that mergers regularly produce efficiency gains is weak at best. In fact, one "study of studies" surveyed data from previous case studies in order to provide a broader view of M&A activity and its effects on the market. Economists Ashenfelter, Hosken, and Weinberg reviewed forty-nine studies and found that nearly three-quarters of them showed mergers resulting in price increases.[100]

Overall, while case studies can contribute to understanding a specific merger or industry at issue and while meta-analyses of these studies can point generally towards the causes of merger gains, the idiosyncrasies of the specific companies and sectors involved limit the ability to generalize from the data. Without more broad-based data, it has historically been difficult to understand the systemic impact of M&A on efficiency and market power.

B. Identifying the Source of Merger Gains: Conclusions from Broad-Based Data

Recently, it appears that the evidence for pronounced market power effects from M&A activity is increasing.[101] There

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99 *Id.*

100 Ashenfelter et al., *supra* note 75, at S78.

101 One recent study finds evidence of "synergy gains" from M&A activities. However, this study defines synergy gains as "the market-value-weighted average of acquirer and target CARs where data for the target is available on CRSP," and as such does not distinguish between market power

have been important advances in the ability of researchers to analyze the sources of gains in M&A transactions, as a number of researchers have now been able to use "micro-level data for a broad set of firms . . . across the economy."[102] These broad-based studies allow researchers to overcome the limitations of the case study approach and provide useful information about the source of gains from M&A activity on the national level. Only a few studies have attempted to use detailed plant- or firm-level data covering a broad set of U.S. firms to draw more representative conclusions about the average effects of M&A activity. Such studies likely provide more generalizable results about the average effects of M&A activity due to their larger sample sizes and more representative compositions.[103] This Section will outline some of the most important examples of such recent research.

One important study used detailed data on a large set of manufacturers to study efficiency gains following different types of asset transfers.[104] In the study, economists Vojislav Maksimovic and Gordon Phillips measured the effects of M&A involving the ownership transfer of 17,720 plants.[105] Although the authors examined multiple types of asset transfers between firms, including those that involve a transfer of only part of a firm's assets, they were able to differentiate between partial asset sales and M&A involving entire firms.[106] The authors found either zero or negative efficiency effects from M&A activity.[107] These effects were modulated by the relative initial productivity of the assets of the buyer and target

effects and efficiency effects. *See* G. Alexandridis et al., *Value Creation from M&As: New Evidence*, 45 J. CORP. FIN. 632, 641 (2017).

[102] Blonigen & Pierce, *supra* note 81, at 6.

[103] *See, e.g.*, *id.* at 2 n.3 (noting that their sample encompassed approximately fifty percent of all M&A activity during the time period).

[104] Vojislav Maksimovic & Gordon Phillips, *The Market for Corporate Assets: Who Engages in Mergers and Asset Sales and Are There Efficiency Gains?*, 56 J. FIN. 2019, 2020 (2001).

[105] *Id.* at 2030.

[106] *Id.* at 2056.

[107] In contrast, the authors found that asset sales that did not constitute M&A positively impacted efficiency. *See id.* at 2056–57.

firms.[108] Maksimovic and Phillips found no evidence of efficiency effects in M&A transactions where the buyer's assets demonstrated initial productivity exceeding those of the target firm.[109] They found negative efficiency effects in M&A transactions where the target firm's assets demonstrated initial productivity exceeding those of the buyer.[110] Overall, the researchers found no evidence that aggregate M&A activity produced any gains in efficiency in the firms studied.[111] Their results suggest that, when examining detailed data on a broad sample of firms, M&A activity does not generate aggregate efficiency gains.

Another highly ambitious study attempted to quantify the effects of all mergers in the world occurring over a period of fifteen years.[112] Economist Klaus Gugler and his coauthors measured the effects of mergers on market power and efficiency by examining detailed accounting data on firm profits and sales.[113] Although the researchers utilized a global data set, roughly half of the mergers in their sample occurred in the United States.[114] The study shows similar results between domestic mergers and the larger global sample group.[115] The authors found that a majority of global mergers over the time period studied either increased market power, reduced efficiency, or both, and could thus be categorized as "welfare reducing."[116] Overall, the study found that only 29.1% of mergers appear to result in efficiency gains, with approximately the same number actually reducing efficiency.[117]

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108 *Id.* at 2056–57.

109 *Id.*

110 *Id.*

111 *Id.*

112 *See* Klaus Gugler et al., *The Effects of Mergers: An International Comparison*, 21 INT'L. J. INDUS. ORG. 625 (2003).

113 *Id.* at 625.

114 *Id.* at 632.

115 *Id.* at 637.

116 *Id.* at 651.

117 *Id.* at 649.

The authors also made a number of more granular findings. First, they found that "the average profitable merger . . . appear[s] to have increased market power."[118] Next, they found that the remaining (unprofitable) mergers likely generate negative efficiency effects.[119] Taken together, these findings indicate that aggregate global M&A activity, both profitable and unprofitable, generates negative social and economic effects.

The study also conducted an examination of the highest and lowest quartiles of M&A activity, measured by the difference between actual and projected profits, which yielded problematic findings.[120] The data indicated that the most profitable mergers tend to generate market power increases.[121] As one might expect, the mergers in the bottom quartile appear to generate even more significant negative efficiency effects than the average unprofitable merger.[122]

The study further breaks down the results by different types of M&A transactions.[123] Profitable instances of both horizontal mergers and conglomerate mergers appear to generate market power gains.[124] However, the results indicate that profitable vertical mergers are "*weakly* consistent" with the hypothesis that they generate efficiency gains, although the results in this area are not statistically significant.[125] The results for unprofitable horizontal, conglomerate, and vertical mergers suggest that these transactions result in losses to efficiency.[126] Thus, although the results for efficiency are broadly similar across different types of mergers, different types of mergers may have distinct effects on firms' market power.

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[118] *Id.* at 643.
[119] *Id.* at 644.
[120] *Id.*
[121] *Id.* at 645.
[122] *Id.*
[123] *Id.* at 644–45.
[124] *Id.* at 644.
[125] *Id.* at 646.
[126] *Id.* at 645.

Finally, the authors made an important distinction between mergers involving firms of different sizes.[127] In their analysis, "large firms" had average sales of approximately $5.7 billion per year, while "small firms" had average sales of approximately $341 million per year, roughly 6% of the magnitude of their larger counterparts.[128] The authors found evidence suggesting that profitable small mergers generate positive efficiency gains.[129] In contrast, they found that profitable large mergers, as with their sample of all profitable mergers, appear to generate market power gains, and that increased size correlates with increased market power.[130] The authors again examined the unprofitable corollaries for mergers of each size, finding that these mergers generate negative efficiency effects.[131] These results again suggest that, although mergers in the aggregate may have negative social and economic effects, certain subsets of mergers can generate positive results. In all, this study reaffirms the notion that mergers, in the aggregate, are "welfare reducing."[132]

The most recent study obtained highly-detailed data for companies representing approximately fifty percent of all M&A activity in the United States.[133] In the study, Bruce Blonigen and Justin Pierce presented data from the entire universe of U.S. manufacturing industries, analyzed over a ten-year horizon.[134] The authors described the breadth of industries their data represents, noting that the data covers "a very broad and diverse set of industries and firms and sectors . . . from timber companies to high-end electronics to toys to printing services."[135] Using novel research techniques and detailed plant-level productivity data, they were able to

[127] *Id.* at 646–47.
[128] *Id.* at 646 n.19.
[129] *Id.* at 646–47.
[130] *Id.* at 646, 649–50.
[131] *Id.* at 646–7.
[132] *Id.* at 651.
[133] Blonigen & Pierce, *supra* note 81, at 2 n.3.
[134] *Id.* at 7.
[135] Rolnik & Schechter, *supra* note 68.

distinguish between potential gains in efficiency and market power with greater specificity and over a much larger set of companies than was possible in most prior studies.[136] Their research convincingly demonstrates that the average merger increased market power.[137] Further, they found that despite promises of synergy and increased efficiency, one subtype of mergers, horizontal mergers (or mergers between competitors), may actually *reduce* firm productivity on average.[138] They also found no statistically significant evidence for efficiency or productivity gains resulting from the full sample of mergers they examined.[139]

In order to ensure that no possible sources of efficiency gains were missed, the authors examined a number of diverse channels often touted as sources of productivity and efficiency gains.[140] First, they tested for efficiency gains that would have increased productivity at the plants in their sample. They found no evidence of efficiency gains through this channel.[141] Despite finding no increases in average plant-level productivity, they hypothesized that firms in the wake of a merger may shift production from low to high-performing plants.[142] This would leave average plant-level productivity unchanged while still increasing productivity at the firm level.[143] However, the authors found no evidence of enhanced productivity through this channel either.[144] The authors also hypothesized that firm-level productivity could be enhanced if firms were to close down underperforming plants following completion of M&A transactions.[145] Here, too, the evidence failed to support the

[136] Blonigen & Pierce, *supra* note 81, at 2.

[137] *Id.* at 3.

[138] *Id.* at 21.

[139] *Id.* at 3 ("We find that M&As significantly increase markups on average, but have no statistically significant average effect on productivity.").

[140] *Id.* at 4.

[141] *Id.* at 19.

[142] *Id.* at 22.

[143] *Id.*

[144] *Id.*

[145] *Id.*

hypothesis.[146] Next, the authors examined another important potential source of efficiency gains: "realizing economies of scale in non-production activities," such as combining non-productive general and administrative activities.[147] Theoretically, such efficiency gains create value by eliminating redundancies and enabling the company to pass the ensuing savings on to its consumers. However, the authors found "no significant M&A effects on non-production employment of the M&A plants and firms, ruling out efficiency effects from realizing scale economies in headquarter services after an M&A."[148] Thus, their research provides strong evidence that economic gains from M&A activity in horizontal mergers come not from the commonly-cited channels for efficiency gains, but instead from increases in market power.

Together, these three broad-based studies suggest an answer to the prior question about the source of gains from M&A activity: merger gains stem from market power increases. Importantly, these studies provide information only in the aggregate, and individual mergers may be more or less likely to induce gains from market power or efficiency.[149] However, this data paints a useful picture of the effects of recent M&A activity and reveals that this activity tends to lead to decreased competition and increased market power in given industries. Consequently, this Article now turns to the economic effects of increased market power.

[146] *Id.* at 23.

[147] *Id.*

[148] *Id.* at 24.

[149] There is some evidence, for example, that non-horizontal mergers, such as vertical and conglomerate mergers, on average produce positive efficiency gains. *See id.* at 21. Thus, the type of merger, and other factors such as the existing degree of competition in the market, barriers to entry, and the nature of the industry, likely play an important role in determining whether a given merger will result in positive, neutral, or negative net efficiency gains. This implies that determining the desirability of a merger is a situation-specific inquiry, with the type of merger as well as other factors likely playing a role in whether or not a given merger will promote an optimal result for shareholders and/or society.

C. The Economic Effects of Market Power Increases

Market power increases enable firms to raise prices in a given industry to the detriment of consumers. A number of studies suggest that such an effect is indeed occurring in a worrying number of industries, corroborating the evidence that merger gains accrue through market power increases. Evidence exists that M&A activity has resulted in market power gains and price increases[150] in industries as diverse as healthcare,[151] airlines,[152] banking,[153] and home appliances.[154] These findings indicate that M&A-induced market power increases have resulted in increased prices in a number of important sectors.

Other recent scholarship paints a similar picture regarding the substantial growth in market power due to M&A activity and sheds light on the resulting negative social and economic effects. A recent meta-analysis of post-merger studies confirms that antitrust regulators in the United States have routinely allowed M&A activity that increases prices. Thirty-

[150] *See* JOHN KWOKA, MERGERS, MERGER CONTROL, AND REMEDIES: A RETROSPECTIVE ANALYSIS OF U.S. POLICY 158 (2015).

[151] *See, e.g.*, Robert A. Berenson et al., *The Growing Power of Some Providers to Win Steep Payment Increases from Insurers Suggests Policy Remedies May Be Needed*, 31 HEALTH AFF. 973, 975–76 (2012); Avik Roy, *Hospital Monopolies: The Biggest Driver of Health Costs that Nobody Talks About*, FORBES: THE APOTHECARY (Aug. 22, 2011, 7:00 PM), https://www.forbes.com/sites/theapothecary/2011/08/22/hospital-monopolies-the-biggest-driver-of-health-costs-that-nobody-talks-about/ [perma.cc/T5S3-GHND].

[152] *See, e.g.*, John Kwoka & Eugenia Shumilkina, *The Price Effect of Eliminating Potential Competition: Evidence from an Airline Merger*, 58 J. INDUS. ECON. 767, 780 (2010) (finding market power gains due to USAir/Piedmont merger).

[153] *See, e.g.*, Ashenfelter et al., *supra* note 75, at S82–83 (finding that five of seven studies of mergers in the banking industry showed price increases).

[154] *See, e.g.*, Orley Ashenfelter et al., *The Price Effects of a Large Merger of Manufacturers: A Case Study of Maytag-Whirlpool*, 5 AM. ECON. J.: ECON. POL'Y 239, 259 (2013) (finding that the merger of Maytag and Whirlpool led to price increases and harmed U.S. consumers).

four of the forty-two mergers studied (81%) resulted in "often substantial" price increases, while only eight showed price decreases.[155] The meta-analysis also found negative effects to product and service quality post-merger as well as other negative anti-competitive effects.[156] These studies illustrate that, post-merger, consumers must pay higher prices, settle for lesser goods, or both.

Further research has shown that excessive market power poses a serious threat to consumers in the United States. Lina Khan and Sandeep Vaheesan write, "[e]vidence across a number of key industries in the United States indicates that excessive market power is a serious problem. Firms in industries ranging from agriculture to airlines collude, merge and exclude rivals, and raise consumer prices above competitive levels, while pushing prices below competitive levels for suppliers."[157]

Thus, there is evidence that excessive market power harms consumers across a range of industries and that M&A activity contributes to this harm.

Problematically, once a corporation achieves substantial market power, it can be difficult to undo the damage caused by market concentration.[158] As discussed above, increased market concentration makes it more difficult for new competitors to emerge and for rivals to expand their operations, leading to damaging effects beyond the noted price increases.[159]

Historically, it was the case that "there simply is no good empirical evidence that any class of stakeholders is systematically harmed by takeovers."[160] However, recent evidence

[155] Carstensen, *supra* note 66, at 248.

[156] *Id.* at 248–49.

[157] Khan & Vaheesan, *supra* note 70, at 236.

[158] Carstensen, *supra* note 66, at 246 ("[U]ndoing [market] concentration by new entry or expansion by marginal competitors has proven of minimal significance despite the theoretical appeal of the contested markets hypothesis. As markets become concentrated, the effect is to 'raise rivals costs' of entry or expansion.").

[159] *Id.* at 251.

[160] Bainbridge, *supra* note 60, at 1008.

strongly suggests that, in the aggregate, M&A activity has increased prices for American consumers. It is no longer possible to assume away the market power effects of M&A activity and the resultant harms to consumers. Thus, this Article now turns to an analysis of the implications of the new research for consumers and society at large.

D. The Implications of Market Power Increases for Consumers & Society

The foregoing Sections have demonstrated that M&A, in the aggregate, leads to increased market power, which in turn yields increased prices. This finding has significant implications for consumer welfare. It also has important distributional effects. This Section will outline the detrimental effects of M&A on consumer welfare and economic inequality.

The most obvious way that price increases harm consumers is that they reduce the amount of goods and services consumers can afford. When prices increase without a corresponding increase in quality or value, consumers must pay more for the same goods or services. This, of course, leaves less to spend on other goods and services, making consumers worse off than before. Likewise, when the quality of goods decreases without a decrease in price, consumers are similarly worse off.

Somewhat less obviously, price increases due to market power gains increase economic inequality. Imagine that Company A and Company B are competitors selling the same product for $1.00. When consumers purchase the product from Company A or Company B, the respective company's wealth increases by $1.00, while each consumer's wealth decreases by $1.00. Now, imagine that Company A and Company B merge. The combined entity has greater market power and raises the price of the product by X amount while leaving the quality unchanged. In this new scenario, when consumers buy the combined entity's new, pricier products, the company's wealth is increased $1.00 + X, while each consumer's wealth is reduced by $1.00 + X. As a result of the merger, each transaction now

includes an additional transfer of X amount of wealth from consumers to the company.

Looking at the ownership structure of most companies, important distributional effects are evident. On average, corporate shareholders are wealthier than the median consumer, and, therefore, they disproportionately benefit from stock price increases and are disproportionately less affected by price increases.[161] Additionally, corporate managers often own large amounts of stock due to the increasing use of stock options and restricted stock in executive compensation, making price increases another way that wealth is transferred from consumers to top executives.[162] It is possible that certain wealth transfers from consumers to shareholders can have the opposite effect. For example, if a group of middle-class tradesmen owned a business making yachts, wealth transfers from rich consumers purchasing yachts to the middle-class owners may act to reduce inequality.[163] However, such instances are rare.[164] Thus, in the aggregate, M&A-induced price increases operate to increase economic inequality.

The aggregate impact of wealth transfers due to market power is quite significant. Some scholars estimate a lower bound for wealth transfers due to market power on the order of hundreds of billions of dollars per year.[165] In a political environment where economic inequality is especially salient, these effects are likely of special relevance to policymakers and scholars, as well as to boards and other fiduciaries charged with managing our companies and stock portfolios.

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161 *See* William S. Comanor & Robert H. Smiley, *Monopoly and the Distribution of Wealth*, 89 Q.J. ECON. 177, 189 (1975) (stating that market power has "a major impact on the degree of [wealth] inequality" in the United States).

162 John C. Coffee, Jr., *What Caused Enron? A Capsule Social and Economic History of the 1990s*, 89 CORNELL L. REV. 269, 274 (2004); *see also* Sharon Hannes & Avraham Tabbach, *Executive Stock Options: The Effects of Manipulation on Risk Taking*, 38 J. CORP. L. 533, 540 (2013).

163 Jonathan B. Baker & Steven C. Salop, *Antitrust, Competition Policy, and Inequality*, 104 GEO. L.J. 1, 17 (2015).

164 *Id.*

165 Khan & Vaheesan, *supra* note 70, at 236.

V. EXAMINING THE IMPLICATIONS OF ECONOMIC DATA

The above data on the source of gains from M&A activity reveals theoretical problems for the shareholder wealth maximization norm and its corollary assumptions. In particular, the fact that mergers increase share prices *at the expense of* consumers implies that wealthy stockholders have divergent interests from middle class, working class, and poor stockholders. This divergence in interests calls into question the utility of share price as an exclusive measurement of financial well-being for all shareholders. Additionally, the fact that mergers increase share prices at the expense of consumers also implies that stockholders in the aggregate have different interests than American society as a whole. Thus, adherence to the shareholder wealth maximization norm in this case does not result in societal betterment, but rather in social harm. This Part examines the traits of American shareholders, the implications of those traits in the context of the shareholder wealth maximization norm, and key lessons for well-meaning corporate directors and corporate law scholars.

A. The Traits of American Shareholders

It is very difficult to speak of the "average" American stockholder, because while roughly half of the population owns some amount of stock, a very small percentage of the population owns a very large percentage of total stock.[166] Thus, the average American stockholder, looking at the pool of all stockholders, varies greatly from the stockholder who owns the average stock, when looking at the pool of all stocks owned. Indeed, the average American stockholder tends to be a middle class person with a relatively modest income, while the average American stock is held by a wealthy person with a relatively large income.[167]

[166] Greenwood, *supra* note 24, at 1035.

[167] *See* Edward N. Wolff, *Who Owns Stock in American Corporations?*, 158 PROC. AM. PHIL. SOC'Y 372, 387–88 (2014).

This situation highlights that American stock ownership is highly correlated with economic class. The very wealthy are very likely to own stock and tend to own a very large amount of stock. For example, 94.9% of the top 1% owns stock directly or indirectly, and this small subset of the population owns 35% of all individually-owned stock.[168] Members of the middle class are somewhat less likely to own stock and tend to own smaller amounts of stock. As an illustration, 44.6% of the middle quintile of Americans own stock directly or indirectly, and this entire quintile only owns 1.8% of all individually-owned stock despite constituting 20% of the overall population.[169] The poor and working class are least likely to own stock, and they tend to own the smallest amount of stock. Only 21.8% of the bottom quintile owns any stock, and this group accounts for only 0.4% of all individually-owned stock.[170] In all, about half of all individually-owned stocks in America are owned by individuals making over $250,000 per year, while half of all individually-owned stocks are owned by individuals making less than $250,000 per year.[171]

Importantly, wealthy stockholders with large portfolios tend to have different financial concerns than middle class or poor stockholders with more modest portfolios. Indeed, earnings from stocks matter far more to the financial bottom line of the wealthy than they do for the middle class and the poor. Investment earnings and retirement funds provide the top 1% with 30% of their annual income, while these income sources provide only 13% of the middle quintile's annual income and just 5% of the bottom quintile's annual income.[172]

168 This data includes direct ownership of stock shares as well as indirect ownership through mutual funds, trusts, IRAs, Keogh plans, 401(k) plans, and other retirement accounts. *Id.* at 387.

169 *Id.*

170 *Id.*

171 *Id.* at 388.

172 JOSEPH ROSENBERG, TAX POLICY CTR., URBAN INST. & BROOKINGS INST. MEASURING INCOME FOR DISTRIBUTIONAL ANALYSIS 5 (2013), http://www.taxpolicycenter.org/sites/default/files/alfresco/publication-pdfs/412871-Measuring-Income-for-Distributional-Analysis.PDF [perma.cc/R76P-RCPV].

Additionally, the rich tend to invest far more than they spend, since they have the discretionary income to do so.[173] In contrast, the poor tend to spend far more than they invest, with the very poor spending roughly eight times as much as they invest.[174] Relatedly, different wealth classes also have vastly different marginal propensities to consume—a measurement which reflects the relative importance of consumer goods prices to each income level. The top 1% spend about 5 cents for each additional dollar brought in, while the middle quintile spends 19 cents for each additional dollar, and the bottom quintile spends 48 cents for each additional dollar.[175]

These facts reveal three different classes of Americans. The first class consists of a few exceedingly wealthy shareholders, who are not very different in their financial interests from the fictionalized caricature of a shareholder.[176] These individuals own a hefty amount of stock, earn a substantial sum from these stockholdings, and are more or less unaffected by price fluctuations in the consumer goods market.[177] This group of Americans cares very much about stock performance, at least from a financial perspective, and likely benefits from M&A activity that yields both increased stock prices and increased consumer goods prices. A second class of Americans consists of all other shareholders. This group of individuals tends to own modest amounts of stock that provide relatively little income. This group spends more on consumer goods and is far more vulnerable to fluctuations in the price of consumer goods.[178] Thus, M&A activity that boosts share prices while inflating consumer goods prices likely harms this subset of

[173] Max Ehrenfreund, *Where the Poor and Rich Really Spend their Money*, WASH. POST: WONKBLOG (Apr. 14, 2015), https://www.washingtonpost.com/news/wonk/wp/2015/04/14/where-the-poor-and-rich-spend-really-spend-their-money/ [perma.cc/HF88-G58A].

[174] *Id.*

[175] Christopher Carroll et al., *The Distribution of Wealth and the Marginal Propensity to Consume*, QUANTITATIVE ECON. (forthcoming June 2017).

[176] Crespi, *supra* note 24, at 388–89.

[177] *See supra* notes 167–174 and accompanying text.

[178] *Id.*

Americans. A third class of Americans represents the interests of American society as a whole. These "average Americans" are more likely not to own any stock than they are to have even a small amount of stockholdings.[179] Moreover, the "average American" earned $74,664 before taxes and had $57,311 worth of annual expenditures, leaving them with very little discretionary income.[180] This group is thus very likely to be harmed by price increases and unlikely to significantly benefit from share price increases.[181] Ultimately, only the first, numerically small class of Americans likely benefits from M&A activity, while the other two classes are likely harmed.

B. The Implications of the Traits of American Shareholders for the Shareholder Wealth Maximization Norm

Given that merger gains accrue, in the aggregate, through price increases, the assumption that shareholder financial benefit can be effectively measured by stock performance does not hold for all stockholders. It is true that, for the very wealthy stockholder, stock price gains likely offset any price increases that they must pay for goods, given that they tend to earn substantial sums of money from stock and spend a relatively small portion of their wealth on consumer goods. For this subset of stockholders, then, stock performance likely *does* provide a suitable measure of their financial well-being. Middle class and poor shareholders, however, tend to spend more than they invest and to make relatively little from their stockholdings. For such shareholders, the excess costs that they must pay for goods and services likely dwarf any gains that may accrue to their stock portfolio, meaning that stock performance provides an incomplete and misleading view of

[179] Wolff, *supra* note 167, at 388.

[180] News Release, Bureau of Labor Statistics, U.S. Dept. of Labor, Consumer Expenditures—2016 (Aug. 29, 2017), https://www.bls.gov/ news.release/pdf/cesan.pdf [perma.cc/Q7Z5-DRLG].

[181] Greenwood, *supra* note 24, at 1083.

the net financial effect of M&A activity on this group of shareholders.

Additionally, the data demonstrating that merger gains derive from price increases rather than synergy gains also complicates the assumption that adherence to the shareholder wealth maximization norm promotes social welfare. Indeed, given that merger gains primarily come at the expense of the consumer, improved stock performance in this context is actually at odds with overall social welfare. When a merger causes stocks to do better, it also causes consumers to do worse. Because very few Americans own substantial amounts of stock, stock market gains through M&A are not a boon to society as a whole. When merger gains must be paid for at the grocery store, pharmacy, or shopping mall, they constitute a net harm to the majority of Americans.

C. Implications for Well-Meaning Directors

Given the foregoing, what is a well-meaning corporate director to do when faced with the decision of whether or not to pursue a merger? A well-meaning corporate director adhering to the shareholder wealth maximization norm in its traditional form should pursue M&A activity that boosts share price, even with the knowledge that those gains come at the expense of both consumers and some portion of the company's shareholders. Indeed, if directors are responsible for maximizing shareholders' wealth, and if that wealth is to be measured by stock performance, then M&A activity that provides a boost to share prices should be embraced and celebrated.

However, if a corporate director chooses to instead embrace shareholder wealth maximization in a broader sense than the narrow focus on share price increases, then marginal M&A activity may become less appealing. Although most directors facing the prospect of a takeover are (and should be) focused primarily on the adequacy of the merger premium, in close cases, directors should consider the potential impact of M&A-induced price increases on their shareholders. At the margins, this may tip the balance of directors' decisions on whether certain mergers provide a net benefit to shareholders, or whether

they should negotiate for a higher premium. Moreover, depending on the magnitude of the merger premium and the resulting price increases to the firm's goods and services, such a merger may actually constitute a net harm to a sizable portion of that firm's stockholders. Thus, a director might conclude that, to truly maximize his or her shareholders' welfare, firm resources are better spent on alternate strategies for growth, such as research and development, than on the pursuit of M&A activities.[182]

Corporate constituency statutes present another wrinkle for the well-meaning director. Forty-four states have passed "other constituency" statutes that permit directors and managers to consider other constituencies' interests in their corporate decision-making processes.[183] Under these statutes, directors are able to take non-shareholders' interests into account.[184] Although directors would be unconcerned with the

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182 Strine, *supra* note 27, at 1908.

183 Examples of "other constituency" statutes include: CONN. GEN. STAT. § 33-756 (2017); 805 ILL. COMP. STAT. § 5/8.85 (1989); KY. REV. STAT. ANN. § 271B.12-210 (West 1988); MASS. GEN. LAWS ch. 156B, § 65 (1996); MINN. STAT. § 302A.251 (2006); N.Y. BUS. CORP. LAW § 717 (McKinney 1989). Only six states—Alabama, Arkansas, Kansas, Michigan, North Carolina, and Oklahoma—have not passed similar legislation. *See* Carol Liao, *A Critical Canadian Perspective on the Benefit Corporation,* 40 SEATTLE U. L. REV. 683, 687 (2017).

184 *See e.g.*, CONN. GEN. STAT. § 33-756 (2017) (providing that a director "may consider in determining what [he or she] reasonably believes to be in the best interests of the corporation . . . the interests of the corporation's employees, customers, creditors and suppliers, and . . . community and societal considerations"); 805 ILL. COMP. STAT. 5/8.85 (1989) (allowing that corporate directors and officers "may, in considering the best long term and short term interests of the corporation, consider the effects of any action . . . upon employees, suppliers and customers of the corporation or its subsidiaries, communities in which offices or other establishments of the corporation or its subsidiaries are located, and all other pertinent factors"); IND. CODE § 23-1-35-1 (2009) (permitting that "[a] director may, in considering the best interests of a corporation, consider the effects of any action on shareholders, employees, suppliers, and customers of the corporation, and communities in which offices or other facilities of the corporation are located, and any other factors the director considers pertinent"); MISS. CODE ANN. § 79-4-8.30 (West 1999) (permitting that "a director, in determining

impact of their M&A activity on society as a whole under the shareholder wealth maximization norm, corporate constituency statutes in many states allow directors to take such considerations into account. Because M&A activity that increases prices is likely to cause financial harm to some shareholders and society as a whole, directors of firms incorporated in states with corporate constituency statutes may be especially obliged to consider potential price increases for their goods and services when determining whether to approve M&A activity.

D. Implications for Well-Meaning Mutual Fund Managers

Of course, corporate directors are not the only agents with the ability to influence whether and to what extent a given firm pursues M&A activity. Because they often control significant portions of a corporation's shares, institutional investors have the power to sway directors towards certain decisions—including the decision to pursue more or less M&A activity.[185] Mutual funds—investment vehicles that pool money from many investors—are currently the biggest bloc of institutional investors, controlling 20.5% of all U.S. equities as of 2015.[186] Though their activism efforts have been more muted than those of other institutional investors, mutual funds

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what he reasonably believes to be in the best interests of the corporation, shall consider the interests of the corporation's shareholders and, in his discretion, may consider . . . [t]he interests of the corporation's employees, suppliers, creditors and customers; . . . [t]he economy of the state and nation; . . . [c]ommunity and societal considerations; . . . [t]he long-term as well as short-term interests of the corporation and its shareholders"); NEB. REV. STAT. § 21-2,102 (2017) (providing that "[a] director may, but need not, in considering the best interests of the corporation, consider, among other things, the effects of any action on employees, suppliers, creditors, and customers of the corporation and communities in which offices or other facilities of the corporation are located").

[185] *See* Martin Gelter, *The Pension System and the Rise of Shareholder Primacy*, 43 SETON HALL L. REV. 909, 958–60 (2013).

[186] *See* SIFMA, 2016 FACT BOOK 83 (2016), https://www.sifma.org/wp-content/uploads/2017/05/sifma-fact-book-2016.pdf [perma.cc/6QVD-J7KY].

traditionally have influenced management decisions by opting or threatening to redirect capital to other investments, and they have increasingly engaged in other forms of activism in recent years.[187]

Their power to influence corporate decision-making raises an important question: what is a well-meaning mutual fund manager to do when faced with the decisions of whether to vote for a merger and whether to urge management to pursue potential M&A activity? Research suggests that many mutual fund managers believe it to be their primary or even sole duty to maximize fund performance.[188] An understanding of the best interests of fund shareholders as essentially indistinguishable from fund performance mimics traditional conceptualizations of the shareholder wealth maximization norm that stress stock performance as the proper measure of stockholders' financial well-being. A mutual fund manager thusly focused on performance would be inclined to urge firms towards M&A activity that increases share prices, even if such increases come at the expense of consumers. However, to *truly* maximize the wealth of fund shareholders, mutual fund managers ought to consider their shareholders' financial interests more broadly, as some mutual fund members might benefit more from a competitive marketplace and competitively-priced goods than from improved stock performance.[189]

In fact, mutual fund shareholders are even more likely than the typical shareholder to be disadvantaged by the market power gains and price increases that tend to accompany M&A activity. While half of all shareholders make more than $250,000 annually, 39% of mutual fund shareholders earn less than $75,000 annually, and 55% earn less than $100,000

[187] Gelter, *supra* note 185, at 960.

[188] Alan R. Palmiter, *Mutual Fund Voting of Portfolio Shares: Why Not Disclose?*, 23 CARDOZO L. REV. 1419, 1461 (2002).

[189] Robert Ashford, *Binary Economics, Fiduciary Duties, and Corporate Social Responsibility: Comprehending Corporate Wealth Maximization and Distribution for Stockholders, Stakeholders, and Society*, 76 TUL. L. REV. 1531, 1574 (2002).

annually.[190] Due to this income differential, mutual fund owners have comparatively less disposable income than traditional shareholders, making them more vulnerable to price increases. Additionally, the purpose of 92% of mutual fund investment is saving for retirement, but 76% of mutual fund owners are employed and thus they have yet to achieve their investment goal.[191] Increased costs for goods and services likely reduce the ability of many mutual fund members to contribute additional capital to their retirement plan, thus hindering their ability to pursue their stated financial goals or forcing them to reduce spending in other areas to compensate.[192] In these ways, mutual fund shareholders are especially likely to be disadvantaged by M&A activity.

Given the characteristics of mutual fund members, mutual fund managers ought to be reluctant to support marginal M&A activity, lest they indirectly subvert the financial well-being of their shareholders. Indeed, depending on the relative magnitude of the change in share price and the increased cost of goods and services, a merger that results in price increases might disserve the majority of mutual fund shareholders by raising prices for goods. In close cases, mutual fund managers considering this broadened conception of shareholder wealth maximization may be more likely to steer management away from M&A activity and towards alternate courses of action more likely to generate net financial benefits for the typical mutual fund member.

E. Implications for Well-Meaning Pension Fund Managers

Pension funds are another group with substantial influence over whether, when, and to what extent directors pursue

[190] Wolff, *supra* note 167, at 388; Kimberly Burham et al., *Characteristics of Mutual Fund Investors, 2015*, ICI RES. PERSP., Nov. 2015, at 1, 5.

[191] INV. CO. INST., 2017 INVESTMENT COMPANY FACT BOOK 113 (57th ed. 2017) (ebook).

[192] *See* Strine, *supra* note 27, at 1880 (noting that most Americans have relatively little surplus to contribute to retirement funds, thus suggesting that increased expenses would further deplete that surplus).

M&A activity. In essence, pension funds are retirement plans that pool contributions from fund members and their employers. Upon retirement, members receive either a pre-set amount (as in a defined benefit plan) or an amount dependent upon stock performance (as in a defined contribution plan).[193] In all, pension funds control roughly fourteen percent of all U.S. equities, and, as such, these entities hold substantial power over U.S. corporations through their voting power, activism, and ability to redirect capital.[194] In fact, pension funds are some of the "most active institutional investors in terms of their attempts to change the management practices of the companies in which they invest."[195]

To what ends should pension funds wield their considerable influence in the context of corporate M&A activity? Although pension fund managers are not the archetypal actor in the shareholder wealth maximization norm, these managers have increasingly adopted the goal of shareholder wealth maximization as an important end for their members.[196] In adhering to this norm, pension fund managers would likely be inclined to promote M&A activity that they believe will increase share prices under the assumption that doing so would yield financial benefits for plan members.

However, do such activities actually benefit the typical pension fund member? An analysis of the characteristics of pension fund members sheds some light on this issue.

The money invested via pensions represents a substantial portion of the retirement funds for a wide swath of American

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[193] S. Burcu Avci et al., *How Should Retirement Plans Be Organized?*, 13 N.Y.U. J. L. & BUS. 337, 346, 348 (2017).

[194] *See* SIFMA, *supra* note 186, at 83. The 14% figure is the sum of three percentages in the U.S. Holdings of Equities by Type of Holder dataset: (1) private pension fund holdings, which were 6.6% in 2015; (2) state and local government retirement fund holdings, which were 6.5% in 2015; and (3) federal government retirement fund holdings, which were 0.6% in 2015.

[195] David Hess, *Protecting and Politicizing Public Pension Fund Assets: Empirical Evidence on the Effects of Governance Structures and Practices*, 39 U.C. DAVIS L. REV. 187, 206 (2005).

[196] Gelter, *supra* note 185, at 963.

workers, such as school teachers, firefighters, police officers, office workers, and sanitation workers.[197] The benefits received from pension funds are generally relatively modest in size. For example, the average amount paid out to public pension fund retirees in 2010 was just under $26,000 per year, roughly half the median income in the U.S.[198] This regular income nonetheless provides an important source of financial security to many Americans. One study found that poverty rates among the elderly were six times greater for those that lacked pension income than for those with it, and that 4.7 million households managed to escape poverty or near-poverty due to their pension income.[199] In all, pensions provided the elderly with 18% of their income as of 2013.[200]

This data suggests that pension fund members tend to be individuals who depend upon their plans for subsistence during retirement. These individuals likely would not benefit from a transfer of wealth from consumers to stockholders and would be more likely to be harmed by M&A activity that yielded market power increases and inflated prices.[201] They would, however, benefit from a corporate governance system focused on sustainable wealth creation by generating jobs, wage growth, and efficiency gains.[202] Moreover, increases in

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[197] David H. Webber, *Is "Pay-to-Play" Driving Public Pension Fund Activism in Securities Class Actions? An Empirical Study*, 90 B.U. L. REV. 2031, 2034 (2010).

[198] Luis A. Aguilar, U.S. Sec. & Exch. Comm'r, Keynote Address at the NAPPA 2012 Legal Education Conference: Pension Funds as Owners and Investors: A Voice for Working Families (June 27, 2012), https://www.sec.gov/news/speech/2012-spch062712laahtm [perma.cc/45KB-H9KD]; KIRBY G. POSEY, U.S. CENSUS BUREAU, HOUSEHOLD INCOME: 2015 1–2 (2016).

[199] NAT'L INST. ON RET. SEC., WHY DO PENSIONS MATTER? 8 (2010) https://www.nirsonline.org/wp-content/uploads/2017/11/final_module2_why_do_pensions_matter.pdf [perma.cc/F8BA-7LUW].

[200] SOC. SEC. ADMIN., NO. 13-11785, FAST FACTS & FIGURES ABOUT SOCIAL SECURITY, 2015, at 7 (2015), https://www.ssa.gov/policy/docs/chartbooks/fast_facts/2015/fast_facts15.pdf [perma.cc/LNS7-E5KN].

[201] Greenwood, *supra* note 24, at 1083.

[202] Strine, *supra* note 27, at 1882.

consumer goods prices likely detract from the amount that pension fund members with defined contribution plans can contribute to their retirement, thus coming at the expense of their financial security in retirement.

Those pension fund members with defined benefit plans are likely to be even more negatively impacted by M&A activity than other working- and middle-class individuals. Members of traditional "defined benefit plans" receive a set benefit upon retirement.[203] Because this benefit is "set," individual pensioners will receive the same benefits upon retirement regardless of the performance of the investments in the plan. This means that they are unable to capture any of the gains in the pension plan's investments. Certainly, individual pensioners hope that the pension plan remains solvent enough to pay out their claims upon retirement, but, beyond this threshold, they are, for good or ill, significantly insulated from stock market returns. In the case of M&A activity, this insulation likely turns out to be for their ill. Pension fund members will directly bear the increased prices resulting from aggregate M&A activity in their capacity as consumers, but will only indirectly, if at all, capture any of the gains generated by these mergers in their capacity as indirect shareholders. In this way, pension fund members with defined benefit plans are forced to bear the negative externalities of M&A without fully—and, sometimes, at all—sharing in its gains.

In light of these facts, it appears that working- and middle-class pension fund members, particularly those with traditional defined benefit pension plans, may be uniquely disadvantaged by M&A activity. Pension fund managers ought to look holistically at the financial concerns of plan members when selecting investments, voting on corporate matters, and engaging in activist efforts. To that end, pension fund managers should wield their considerable power to oppose marginal M&A activity, as the harms to pension fund recipients in their capacity as consumers of goods and services may exceed any benefits in the form of share price gains. Only by looking at

[203] *See id.* at 1879 n.20.

the interests of pension members in a broader sense than gains to share price can pension fund managers truly act in the financial best interests of the typical pension fund member.

F. Implications for Well-Meaning Hedge Fund Managers

Hedge funds form a third group of institutional investors with considerable power over whether and to what extent corporate directors pursue M&A activity. The hedge fund industry's influence comes not only from its control of over $3 trillion worth of assets, but also from the tendency of hedge funds to be more active and involved investors relative to other financial market actors, such as mutual and pension funds.[204] Many "activist" hedge funds aggressively push for specific changes at the companies in which they invest. Although activist hedge funds represent a minority of all hedge funds, their numbers and activity have ballooned in recent years, driving them to the forefront of corporate executives' collective consciousness.[205]

A great deal has been written regarding the effects of hedge fund activism on U.S equity markets. Consistent with the shareholder wealth maximization norm, research on hedge fund activism tends to focus on its effect on stock performance. Some scholars argue that activism positively

[204] *Hedge Fund Industry Capital Surpasses Historic $3 Trillion Dollar Milestone*, HEDGE FUND RES. (Jan. 20, 2017), https://www.hedgefundresearch.com/news/hedge-fund-industry-capital-surpasses-historic-3-trillion-dollar-milestone [perma.cc/KQT2-TEJC]; Marcel Kahan & Edward Rock, *Hedge Fund Activism in the Enforcement of Bondholder Rights*, 103 NW. U. L. REV. 281, 282 (2009) ("[H]edge funds tend to pursue active and aggressive investment strategies.").

[205] *See, e.g.*, Coffee & Palia, *supra* note 27, at 548 ("Hedge fund activism has recently spiked, almost hyperbolically."); *see also* Marcel Kahan & Edward B. Rock, *Hedge Funds in Corporate Governance and Corporate Control*, 155 U. PA. L. REV. 1021, 1026 (2007).

influences returns to shareholders.[206] Others contend that while the short-term returns may be positive, hedge fund activism can be harmful to companies in ways that are only evident over longer time horizons.[207] This issue, while hotly contested, remains unsettled.

Regardless of whether hedge fund activism generates short-term or long-term returns, it is clear that one of the primary strategies for achieving these returns involves M&A activity. In fact, pushing the target company into M&A activity

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[206] *See, e.g.*, Lucian A. Bebchuk et al., *The Long-Term Effects of Hedge Fund Activism*, 115 COLUM. L. REV. 1085, 1155 (2015) (noting that there is an "initial positive stock-price spike accompanying activist interventions" and that this spike reflects "correctly the intervention's long-term consequences"); Alon Brav et al., *Hedge Fund Activism, Corporate Governance, and Firm Performance*, 63 J. FIN. 1729, 1730 (2008) (summarizing their findings that "find that the market reacts favorably to activism, consistent with the view that it creates value"); April Klein & Emanuel Zur, *Entrepreneurial Shareholder Activism: Hedge Funds and Other Private Investors*, 64 J. FIN. 187, 189 (2009) (finding a significantly positive market reaction for activist hedge funds' activities).

[207] *See, e.g.*, Leo E. Strine, Jr., *One Fundamental Corporate Governance Question We Face: Can Corporations Be Managed for the Long Term Unless Their Powerful Electorates Also Act and Think Long Term?*, 66 BUS. LAW. 1, 12 (2010) ("[I]t is increasingly the case that the agenda setters in corporate policy discussions are highly leveraged hedge funds, with no long-term commitment to the corporations in which they invest."); Martin Lipton, *Empiricism and Experience; Activism and Short-Termism; the Real World of Business*, HARV. L. SCH. F. ON CORP. GOVERNANCE & FIN. REG. (Oct. 28, 2013), http://blogs.law.harvard.edu/corpgov/2013/10/28 /empiricism-and-experience-activism-and-short-termism-the-real-world-of-business/ [perma.cc/T6TL-Z922] ("While there is no question that almost every attack, or even rumor of an attack, by an activist hedge fund will result in an immediate increase in the stock market price of the target, such gains are not necessarily indicative of real value creation. To the contrary, the attacks and the efforts by companies to adopt short-term strategies to avoid becoming a target have had very serious adverse effects on the companies, their long-term shareholders, and the American economy."); Anabtawi, *supra* note 26, at 564 ("[T]he hedge fund is likely to favor policies by the firms in which it invests that produce short-term gains, even if a more patient investment orientation would generate higher returns over the long term.").

is by far hedge fund activists' most lucrative strategy.[208] Successful takeovers serve as the driving force behind activist hedge funds' ability to generate long-term abnormal positive returns.[209] Numerous scholars concur in this sentiment. Yvan Allaire & François Dauphin write, "[g]etting companies merged or sold off is a clear driver of hedge fund performance."[210] John Coffee and Darius Palia note that the "evidence suggests that changes in the expected takeover premium, more than operating improvements, account for most of the stock price gain, both in short-term and long-term studies."[211] Indeed, an analysis of 1740 activist interventions showed that the returns from a takeover of the target company were almost double those of any other strategy employed by activist hedge funds.[212] Another study by Alon Brav, Wei Jiang, Frank Partnoy, and Randall Thomas generated similar data, also finding that activism aimed at pushing the target company to sell produced better returns than any other strategy.[213] Further confirmation comes from Robin Greenwood and Michael Schor, who find that targets of hedge fund activism that are ultimately acquired generate positive abnormal returns but that targets which are not acquired generate abnormal returns of zero.[214] William W. Bratton concludes, after conducting a review of the relevant literature, "[t]here is no question that activism prompts mergers."[215]

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[208] Marco Becht et al., *Returns to Hedge Fund Activism: An International Study*, 30 REV. FIN. STUD. 2933, 2935 (2017).

[209] Coffee & Palia, *supra* note 27, at 588.

[210] Yvan Allaire & François Dauphin, *The Game of 'Activist' Hedge Funds:* Cui Bono?, INT'L J. DISCLOSURE & GOVERNANCE, Nov. 2015, at 25.

[211] Coffee & Palia, *supra* note 27, at 588.

[212] *See* Becht et al., *supra* note 208, at 2954–55.

[213] Brav et al., *supra* note 206, at 1759.

[214] Robin Greenwood & Michael Schor, *Investor Activism and Takeovers*, 92 J. FIN. ECON. 362, 363 (2009) ("[T]he returns associated with activism are largely explained by the ability of activists to force target firms into a takeover, thereby collecting a takeover premium.").

[215] William W. Bratton, *Hedge Fund Activism, Poison Pills, and the Jurisprudence of Threat* 13 (U. Pa. L. Sch. Inst. L. & Econ. Research Paper

The increased M&A activity prompted by mergers has significant negative implications. As discussed at length in Part IV of this paper, studies indicate that, in the aggregate, M&A activity increases prices and produces zero, or sometimes negative, efficiency effects.[216] As we have seen, hedge fund activism relies on pushing target companies into mergers to generate the bulk of activists' returns. Thus, based on the existing research, it is likely that hedge fund activists' most profitable strategies result in increased prices and reductions in consumer surplus. This represents an important, and heretofore unmentioned, negative externality of hedge fund activism.

Indeed, if merely reflective of M&A activity in general, the increased M&A activity due to hedge fund activism would result in the same level of increased prices and reductions to consumer surplus as other M&A transactions. However, because of the nature of hedge fund activism, the particular M&A activity generated by activist hedge funds may be even more damaging. By their nature, activist hedge funds tend to conduct their activism within large, publicly-traded companies. When a hedge fund makes use of its most lucrative strategy, pushing the target company to sell, the pool of potential buyers for a large, publicly-traded company is largely restricted to other large, publicly-traded companies.[217] This is a perfect recipe for increases in market concentration and market power. If restricted to large, publicly-traded companies, theory predicts an increase in the negative externalities of M&A activity. First, publicly-traded companies are likely to have already reached levels of production that limit efficiency gains from economies of scale.[218] This means that these large

Series, Paper No. 16-20, 2016), https://papers.ssrn.com/ sol3/papers.cfm?abstract_id=2835610## [perma.cc/WF27-PKVA].

216 *See generally* Blonigen & Pierce, *supra* note 81.

217 In fact, there is evidence that the companies that activists target for sale are substantially larger than the median company targeted by activists. *See* Allaire & Dauphin, *supra* note 210, at 20.

218 Carstensen, *supra* note 66, at 252 ("First, as a matter of logic, it is unlikely that mergers among major market competitors will significantly affect economies of scale or scope. Empirical studies provide significant support for this conclusion.").

M&A transactions may be even less likely than the average M&A deal to result in meaningful efficiency gains. Second, because of their large size, there is an increased probability that the combination of such firms will increase market power.[219] All else being equal, the combination of two large firms will produce an entity with greater market power than will the combination of two smaller firms. Because activist hedge fund returns largely depend on finding buyers for large, publicly-traded firms, one would theoretically expect that their activity results in market power increases that are even more damaging than the average M&A transaction. Empirical results confirm this theory, as evidence suggests that, relative to mergers by small firms, mergers by large firms are both less likely to generate efficiency gains and more likely to generate market power gains.[220] Thus, both theory and evidence suggest that hedge fund activism produces M&A activity that is normatively worse than the average M&A transaction from the perspective of both efficiency gains and market power gains.

The fact that hedge funds promote M&A activity that harms consumers in the aggregate raises an important question: how should hedge fund managers balance the need to generate returns for the fund against the very real negative effects that M&A-induced price increases have on consumers? To the extent that hedge funds embody their stereotype as the investment vehicle of the ultra-wealthy and adhere to the shareholder wealth maximization norm, hedge fund managers ought to continue to promote M&A activity even given increasing awareness of resultant market power effects, since the wealthy likely receive a net financial benefit from such activity.[221]

[219] Allaire & Dauphin report that larger firms (in the top quintile of market capitalization for companies sampled) are even *more likely* to be pushed into sale than a standard activist target. *See* Allaire & Dauphin, *supra* note 210, at 23.

[220] Gugler et al., *supra* note 112, at 646.

[221] ROBERT A. JAEGER, ALL ABOUT HEDGE FUNDS vii (2003) (remarking on the stereotypical representation of hedge funds as "secretive,

Data, however, suggests that many hedge funds indirectly serve investors of more modest means—pension funds members.[222] In all, pension funds provide approximately forty percent of hedge funds' capital.[223] Because pension funds can qualify as "accredited investors,"[224] they are able to funnel money to hedge funds from individuals who otherwise would be barred from hedge fund investments.[225] These individuals are likely to be sensitive to the price increases and resulting negative impacts on consumer welfare caused by hedge fund activism mediated through M&A activity. In fact, it is likely that these individuals are *more* negatively impacted than other working- and middle-class individuals. As discussed above, those pension fund members who take part in traditional defined-benefit pension plans are insulated from stock market gains and are uniquely harmed by M&A-induced price increases. When considering that the M&A activity generated by hedge fund activism likely results in even greater market power gains than the average M&A transaction, this harm is magnified. Thus, hedge fund activism is likely uniquely harmful to many pension fund members. In this light, hedge fund activism and its focus on promoting M&A activity may be disadvantageous for a substantial subset of hedge fund investors. Hedge fund managers who take a more holistic view of their members' well-being should be more hesitant to promote M&A activity, and pension fund managers should likewise be much more hesitant to invest in activist hedge funds.

unregulated investment vehicles that enable wealthy individuals to make highly leveraged speculative bets in the global financial and commodity markets").

[222] *See* Strine, *supra* note 27, at 1959 ("The hedge fund industry cannot function at its current scale without finding investments from pension funds and the like . . . .").

[223] PREQIN, 2014 PREQIN GLOBAL HEDGE FUND REPORT 10 fig.7.22 (2014), https://www.preqin.com/docs/reports/The_2014_Preqin_Global_Hedge_Fund_Report_Sample_Pages.pdf [perma.cc/4MU3-WDQ3].

[224] *See* 17 C.F.R. § 230.501(a) (2016).

[225] Strine, *supra* note 27, at 1935.

G. Implications for Scholars

In his essay *The American Scholar*, Ralph Waldo Emerson outlines the duties of a scholar: "[t]he office of the scholar is to cheer, to raise, and to guide men by showing them facts amidst appearances."[226] It is clear that the traditional conceptualization of the purpose of a corporation involves many appearances. Stock performance *appears* to be an acceptable way to measure shareholder financial benefit. Adherence to the shareholder wealth maximization norm *appears* to benefit society as a whole. In the context of gains from M&A activity, these appearances do not translate into facts. Stock performance provides an imperfect measure of shareholder financial benefit, and it can actually be used to hide concrete harms to the "human investors" who make up a sizable percentage of the stockholding population. Perhaps even more problematically, adherence to the shareholder wealth maximization norm can generate substantial harms to society as a whole, serving more as a transfer of wealth from poor and working class consumers to extremely wealthy investors than as a "rising tide" lifting all boats. Scholars thus have a duty to look beyond stock performance and examine alternative measures of financial well-being and to question the assumption that gains to shareholders will necessarily translate to gains for society as a whole. In order to provide sound advice for policymakers, these scholars need to look critically at corporate practices generally and M&A activity in particular to expose the areas where shareholders' financial interests may be at odds with each other and with social welfare. It is only with this perspective that directors and policymakers can pursue the strategies and policies that best serve American society.

VI. CONCLUSION

This Article advances two central arguments: first, share price gains do not always represent increases in the welfare of

226 RALPH WALDO EMERSON, *The American Scholar*, *in* RALPH WALDO EMERSON ESSAYS & LECTURES 51, 63 (Joel Porte ed., 1983).

individual shareholders; and second, share price gains do not always represent increases in societal welfare. In advancing these arguments, this Article presents a challenge to the traditional conception of the shareholder wealth maximization norm. This conception has allowed boards of directors and other corporate actors to serve fictionalized versions of their real shareholders. It has also allowed corporate actors to ignore the true impact of their actions on the very individuals in whose best interests they purport to act.

This Article uses M&A activity as a lens through which to examine some of the central claims of the shareholder wealth maximization norm. This examination reveals that the traditionalist conception of shareholder wealth maximization is limited and problematic in a number of ways. Although M&A activity may increase share prices, the evidence suggests that it also produces undesirable social and economic effects. Despite the fact that these results emerge in the context of M&A activity, they should perhaps cause us to reexamine the impact of the shareholder wealth maximization norm in other areas as well. Further study in this area is therefore advisable.

This Article does not attempt to prove that the shareholder wealth maximization norm is "wrong," either positively or normatively, but rather that it is overly narrow and that the costs it imposes on society are both significant and poorly understood. Even so, it may still be the best and most workable conception of corporate purpose. However, as scholars continue the spirited debate regarding corporate purpose, a more accurate understanding of the costs and benefits of the shareholder wealth maximization norm is essential. If these costs are ignored, it is to the detriment of substantial numbers of shareholders and consumers.