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Director Duties & Enlightened Shareholder Value: Four Elements of Effective Governance

I. INTRODUCTION

The social devastation of 2020 accelerated a march to reconceive corporate purpose from fringe to mainstream concern. Challenging the received wisdom that shareholder value is the corporation's ultimate end ("shareholder primacy"), advocates for "stakeholder governance" argue that business leaders should serve an array of constituencies affected by, or interested in, corporate decisions. This once-radical position is increasingly resonant for global companies.

In the United States, the Business Roundtable—representing over 180 of the country's largest companies—issued a "Statement on the Purpose of a Corporation" (the 'BR Statement') avowing "a fundamental commitment to all of our stakeholders", including customers, employees, suppliers, communities, and shareholders.[1] The same group was previously unequivocal that "the paramount duty of management and of boards of directors is to the corporation's stockholders."[2] (Despite revolutionary hues, the statement is arguably tautological if relevant stakeholder interests are limited to those that bear on shareholder value.[3])

The stakeholder-centric approach has gained far more traction across the Atlantic, where the European Commission has made it central to the 2021 *Sustainable Corporate Governance Initiative*. As part of that Initiative, the Commission recently completed a *Study on Directors' Duties and Sustainable Corporate Governance*[4] and has solicited public comment on potential legislative amendment of board duties to capture the full panoply of stakeholders (beyond even those imagined by the BR Statement), possibly with rights enforceable by each. While nascent, it is a path that could radically change corporate law across Europe, with profound, expansive, and unpredictable implications.

This memo argues that the quest for a radically new corporate governance regime—entertained in the European Commission's public engagement—is colored by a flawed assumption: that meaningful stakeholder governance is inexorably at odds with shareholder primacy. Rather, we suggest, committed boards can effectively and in good faith respond to stakeholder interests even under the aegis of the

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1 The Business Roundtable, "Statement on the Purpose of a Corporation" (August 2019), https://system.businessroundtable.org/app/uploads/sites/5/2021/02/BRT-Statement-on-the-Purpose-of-a-Corporation-Feburary-2021-compressed.pdf (last visited 2 March 2021).

2 The Business Roundtable, "Statement on Corporate Governance" (September 1997), http://www.ralphgomory.com/wp-content/uploads/2018/05/Business-Roundtable-1997.pdf (last visited 2 March 2021).

3 *Report to the Board of Directors of JPMorgan Chase & Co. Regarding Public Benefit Corporations* (January 2021) at 3 ("if the interests of the stockholders and the other constituencies conflict, ...the board's fiduciary duties require it to act in a manner that furthers the interests of the stockholders.") available at https://www.jpmorganchase.com/content/dam/jpmc/jpmorgan-chase-and-co/documents/public-benefit-report.pdf (last visited 2 March 2021).

4 European Commission, *Study on Directors' Duties and Sustainable Corporate Governance: Final Report* (July 2020), https://op.europa.eu/en/publication-detail/-/publication/e47928a2-d20b-11ea-adf7-01aa75ed71a1/language-en (last visited 2 March 2021).

most conservative directors' fiduciary duty regimes. The challenge is implementing calibrated and credible governance.

We begin by surveying criticisms of stakeholder governance as both voluntary aspiration and legal obligation. We then consider the contours of directors' fiduciary duty in an archetypal shareholder-primacy jurisdiction, Delaware, which is both dominant in U.S. corporate law and largely reflective of directors' duties across jurisdictions. Drawing on these criticisms and legal imperatives, we close with four practical elements of corporate governance for boards to deliver meaningfully on commitments to stakeholder governance, while navigating an array of emerging business risks and opportunities.

II. CRITIQUES OF STAKEHOLDER GOVERNANCE

Criticisms of stakeholder governance fall into two broad categories: meaninglessness and radicalism. The former alleges that voluntary stakeholderism is a mere marketing maneuver.[5] In this view, the BR Statement was largely "a rhetorical public relations move" which "was not expected by signatories to bring about major changes."[6] The manner in which many US multinationals responded to the Covid pandemic bolsters this critique.[7] Indeed, a Ford Foundation-funded study recently found that being a BR signatory had a *negative* effect on a company's management of Covid issues and a minimally positive effect on its management of inequality-related matters.[8]

The radicalism critique comes from the other end of the spectrum and questions the core aims of stakeholder governance as voluntary or legal enterprise.[9] It has several variants. *First*, fiduciaries for all are accountable to none. Without clear prescriptions of relevant stakeholders and the relative weight of their interests, corporate leaders would be left with enormous discretion, which could "insulate [them] from shareholder oversight"[10] (and that of other groups). *Second*, and related, a good-faith fiduciary for all may paralyze boards fearful of offending any constituency, particularly the media-savvy and litigious. *Third*, an overly broad fiduciary duty would dilute the value of corporate investment and finance by restricting ownership rights and injecting unpredictability into corporate decision-making.

Any meaningful engagement with stakeholder governance would need to navigate both poles of skepticism to be effective.

III. THE LIMITS ON STAKEHOLDER GOVERNANCE UNDER DELAWARE LAW

There are nuances across jurisdictions in the scope of directors' duties, avenues for their enforcement, and deference owed to board decisions. But shareholder primacy remains the general legal rule. Delaware's corporate governance regime is among the more conservative manifestations of this rule. It

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5 For a comprehensive survey of these criticisms, see Lucian A. Bebchuk and Roberto Tallarita, "The Illusory Promise of Stakeholder Governance", 106 Cornell L. Rev. 91 (forthcoming), available at https://live-cornell-law-review.pantheonsite.io/wp-contenThet/uploads/2021/02/The-Illusory-Promise-of-Stakeholder-Governance.pdf (last visited 2 March 2021).

6 *Id*. at 98, 133.

7 Peter S. Goodman, "Big Business Pledged Gentler Capitalism. It's Not Happening in a Pandemic", *New York Times*, (April 13, 2020). Available at: https://www.nytimes.com/2020/04/13/business/business-roundtable-coronavirus.html (last visited 2 March 2021).

8 *COVID-19 and Inequality: A Test of Corporate Purpose* (September 2020), available at https://337827c9-ebc5-4704-b7bd-0ba2e859ee47.filesusr.com/ugd/f64551_cad4d1c1808343258f2b57fb8fff90d9.pdf (last visited 2 March 2021).

9 *See* Bebchuk & Tallarita, supra note [5], at 164-73.

10 *Id.* at 108.

therefore serves as a useful guide to the limits placed on stakeholder governance by existing board fiduciary duties.

Under Delaware law, the board of directors is responsible for managing the business and affairs of the corporation[11] and is bound by the fiduciary duties of "loyalty and care."[12] As a general matter, directors enjoy broad discretion to determine which corporate actions will advance shareholder welfare. Applying the 'business judgment rule', Delaware courts presume that directors "acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company,"[13] and put the burden on the plaintiff to rebut this presumption. Absent a showing of gross negligence, bad faith or self-dealing, the board's decisions "will not be disturbed if they can be attributed to any rational business purpose."[14]

Despite this deference, director discretion is not unfettered. Courts have repeatedly emphasized that their fiduciary duties require directors to "make stockholder welfare the sole end of corporate governance."[15] While a board may take other constituencies into consideration, it should do so "only instrumentally to advance" the best interests of shareholders.[16] Bad faith may be found "where the fiduciary intentionally acts with a purpose other than that of advancing the best interests of the corporation."[17] The presumed synchrony between the corporation's best interests and stockholder wealth is most clear in change-of-control scenarios: where the time horizon is fixed by the transaction, the board must seek "the highest value reasonably attainable for shareholders."[18]

Delaware's avowed commitment to shareholder welfare precludes board decisions that would explicitly sacrifice stockholder value at the altar of other constituencies' interests. At the same time, however, the business judgment rule affords directors in most circumstances broad latitude to consider non-shareholder interests as long as they are rationally related to the corporation's best interests.[19] Significantly, save in change-of-control scenarios, the rule does not require that shareholder value be determined over any particular time horizon: a board can legitimately keep its gaze fixed on the best interests of the corporation in the indefinite future. In short, even when constrained by shareholder primacy, boards have the legal discretion meaningfully to consider stakeholder interests through the prism of long-term shareholder welfare.

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[11] 8 Del. C §141(a).

[12] The duty of loyalty compels directors to act in "good faith" and in "the best interest of the corporation and its shareholders." See *In re Orchard Enters., Inc.,* 88 A.3d 1, 32-33 (Del. Ch. 2014). The duty of care requires directors "to inform themselves, prior to making a business decision, of all material information reasonably available to them. Having become so informed, they must then act with requisite care in the discharge of their duties." *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984).

[13] *Id.*

[14] *Sinclair Oil Corp. v. Levien*, 280 A.2d 717, 720 (Del. 1971).

[15] Leo E. Strine, Jr., "The Dangers of Denial: The Need for a Clear-Eyed Understanding of the Power and Accountability Structure Established by the Delaware General Corporation Law", 50 Wake Forest L. Rev. 761, 763 (2015).

[16] Leo E. Strine, Jr., "Our Continuing Struggle with the Idea That For-Profit Corporations Seek Profit", 47 Wake Forest L. Rev. 135, 147 n. 34 (2012).

[17] *In re Walt Disney Co. Deriv. Litig*., 907 A.2d 693, 755 (Del. Ch. 2005).

[18] *Mills Acq. Co. v. MacMillan, Inc.*, 559 A.2d 1261, 1288 (Del. 1989). See also *Revlon Inc. v. Macandrews & Forbes Hldgs., Inc.*, 506 A.2d 173, 182, 184 n. 16 (Del. 1986).

[19] *See* Lynn A. Stout, *The Problem of Corporate Purpose*, *Issues in Governance Studies* (June 2012), available at: https://www.brookings.edu/wp-content/uploads/2016/06/Stout_Corporate-Issues.pdf (last visited 2 March 2021).

The ideal of weaving stakeholder governance into a sophisticated pursuit of stockholder wealth is "enlightened shareholder value", which is entirely consistent with the discretion afforded to directors in stakeholder-primacy jurisdictions, including across Europe. This discretion dissolves the assumed dichotomy between stakeholder governance as responsibility to the world at large and stakeholder primacy as short-term share-price obsession. (A notable misleading question posed by the European Commission: "Do you believe that corporate directors should balance the interests of all stakeholders, instead of focusing on the short-term financial interests of shareholders, and that this should be clarified in legislation as part of directors' duty of care?"[20])

Indeed, shareholder primacy increasingly *requires* a commitment to enlightened shareholder value in light of the solid evidence of stakeholder materiality to share price, the heightened scrutiny of investors to stakeholder governance, and the multiplying regulations mandating rigorous non-financial due diligence and disclosure. As Blackrock CEO Larry Fink recently wrote, "[c]ompanies ignore stakeholders at their peril... the more [a] company can show its purpose in delivering value to its customers, its employees, and its communities, the better able [it] will be to compete and deliver long-term, durable profits for shareholders."[21]

IV. "ENLIGHTENED SHAREHOLDER VALUE": FOUR KEY ELEMENTS OF IMPLEMENTATION

Enlightened shareholder value does not require a paradigm shift in the legal conception of corporate purpose. But its inherent flexibility and context-sensitivity leave it open to the same criticisms as stakeholder governance, particularly the charges of puffery and lack of accountability. The challenge for sincere, stakeholder-interested boards is thus multidimensional. Effective stakeholder-governance measures must be (*i*) practical, (*ii*) demonstrably in service of shareholder interests, (*iii*) credible to critics of director overreach, and (*iv*) attuned to the expanding universe of investor, customer, legal, and civil society expectations and their dynamic interplay.

We highlight below four key elements of effective stakeholder governance to help boards chart these challenges and criticisms while respecting shareholder primacy.

1. Clear Commitment

a. An effective public commitment to stakeholder governance serves multiple ends. *First*, it provides meaningful transparency to shareholders regarding the board's management approach. *Second*, it reassures stakeholders that the company is alive to their concerns, thereby mitigating a suite of reputational, operational, financial, and legal risks. *Third*, it signals to courts and regulators that shareholder value remains the board's ultimate concern. *Fourth*, it preserves a domain of legitimate discretion for the board to carry out its responsibilities in distinct contexts, particularly since such commitments can easily become actionable representations. These ends depend on balancing precision and parsimony.

    i. The commitment's structure can take many forms. While being concise, it should:

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[20] European Commission, *Sustainable Corporate Governance: Public Consultation*, Question 8, available at https://op.europa.eu/en/publication-detail/-/publication/e47928a2-d20b-11ea-adf7-01aa75ed71a1/language-en (last visited 8 February 2021).

[21] "Larry Fink's 2021 Letter to CEOs" (February 2021), available at https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter (last visited 2 March 2021).

1. Offer a clear business rationale for why the company is attuned to diverse stakeholder interests.
2. Highlight the time horizon on which the board operates in assessing shareholder value and the concerns of stakeholders.
3. Explain which constituencies are relevant to the company's stakeholder governance (and why).
4. Summarize how relevant stakeholder interests and concerns will be identified and incorporated in business strategy, ideally with reference to cornerstone standards[22] to ensure credibility and constrain representations.

2. *Structured Diligence*

a. Diligence is the cornerstone of stakeholder governance, both to ensure effective corporate strategy and to preserve program credibility. The first priority is to ensure that the board is considering and prioritizing stakeholder interests strategically, in a way that efficiently advances shareholder value (albeit over the long term). The second is to ensure that the company's commitment to stakeholder governance is perceived as being in good faith by key constituencies—who may often have disparate interests. To these ends, structure, precision, and coherence are critical.

   i. Diligence can be structured in different ways to align with corporate culture and the cornerstone standards. At a minimum, it should seek to identify:

      1. Material risks to stakeholders (likely to impact shareholder value).
      2. Salient risks to stakeholders (the most severe harms to stakeholders, which are critical to cornerstone standards and increasingly inform regulatory expectations).
      3. Material stakeholder opportunities (stakeholder concerns that offer business benefits based on the company's products, services, and brand).

   ii. The diligence should be based on precise indicators of risk and degree to enable targeted assessment, prioritization, and monitoring for strategy design and disclosure.

   iii. To ensure broad credibility, the diligence structure and indicators should integrate and align with national law, all cornerstone standards, and definitions of harm under international law.

3. Coherent (Stakeholder) Strategy

a. The aim in strategy design is to develop an approach to addressing stakeholder concerns that is broadly credible, focused on the right priorities based on the business's operating context and risks, and coheres with the company's overarching ambitions. To ensure credibility, the strategy will need to give pride of place to stakeholder interests. To avoid charges of director overreach, however, the strategy should remain clearly directed to

[22] In general, there are five standards shaping the array of emerging sustainability risks and expectations: UN Guiding Principles on Business and Human Rights, OECD Guidelines for Multinational Enterprises, Sustainable Accounting Standards Board, Taskforce on Climate-related Financial Disclosure, and the Sustainable Development Goals.

long-term shareholder value and aligned with the broader business vision. Vigilance towards both these ends should involve segregated analysis of stakeholder concerns followed by considered integration into an overarching strategy.

i. To ensure efficiency and accountability, relevant stakeholder priorities should be identified with sufficient precision to disaggregate analysis by type, time horizon (short, medium, long), and priority (materiality, salience, opportunity).

ii. To ensure strategic reasonableness and durability, priority stakeholder concerns should then be woven into broader business strategy, which would also blunt any charge that stakeholder and shareholder pursuits are distinct.

4. *Calibrated Disclosure*

a. Disclosure is critical to stakeholder credibility and shareholder accountability. Without it, the best commitments, diligence, and strategy may fail to advance enlightened shareholder value in any meaningful way. Effective disclosure calibrates between untrammeled transparency, legalistic caveating, and shallow marketing. It should provide sufficient insight regarding the company's governance for (i) stakeholders to believe that their interests have actually been considered and (ii) shareholders to understand what considerations and processes are driving the company's business decisions. As with commitments, disclosure can ground legal liability, so any representations must be thoroughly vetted for accuracy.

i. The form and intensity of disclosure may be calibrated to these ends. At a minimum, it should:

1. Ensure coherence between the company's overarching brand and its stakeholder strategy, to demonstrate that the pursuit of stakeholder interests is neither shallow nor distinct from the pursuit of shareholder value.

2. Highlight key stakeholder governance policies and procedures driving the company's approach to provide accountability and guard against charges of arbitrariness.

3. Regularly disclose priority non-financial issues and how they were determined—recognizing that the latter is often more important than the former in establishing trust of diverse audiences.

4. Explain how stakeholder priorities were integrated into the overarching business strategy and how their incorporation impacts stakeholders and advances shareholder value.

V. CONCLUSION

As a corporate pursuit, enlightened shareholder value is unlikely to set hearts aflutter. Incrementalism rarely does. But it does offer a practical alternative to the extremes of myopic share-price obsession and unfettered director discretion. Pursued in good faith, enlightened shareholder value can represent a meaningful break from shareholder primacy—with enduring gains for shareholders and stakeholders alike—without making corporate leaders fiduciaries for the world, inviting the profound and unpredictable consequences of such unbridled responsibility. That is not to say that more should not be expected of businesses with respect to the environment, workers, and communities. Rather, those ends are better pursued through targeted legislation that does not reimagine business as a public enterprise.