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The Business Judgment Rule in Stakeholder Capitalism

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The Business Judgment Rule in Stakeholder Capitalism

Thiago Spercel[*]

Abstract:

The tension between shareholder primacy and stakeholder capitalism embodies a fundamental debate about the purpose of a corporation. These two perspectives offer contrasting views on whether a company should primarily serve the interests of its shareholders or consider the broader spectrum of stakeholders in its decision-making process, taking into account environmental, social and governance factors alongside financial performance. The Dodd-Berle debate from the 1930s and Milton Friedman's teachings in the 1970s regarding the purpose of a corporation and the tension between shareholder primacy and stakeholderism have been reinvigorated. On the one hand, ESG considerations have become increasingly important in risk mitigation and shareholder value protection, since externalities are becoming more extreme, requiring urgent coordinated action that cannot be handled by government regulation alone. If not addressed, these issues could create systemic risks impacting all businesses at once. Stakeholder capitalism nonetheless receives criticism for its flaws in capital allocation, unclear measurement and disclosure, lack of accountability, negative impact on financial performance, and distraction from the need for government regulation. Certain extreme situations of stakeholder-centric decisions that cannot be reconciled with value creation for shareholders could potentially constitute a breach of management's duty of loyalty if they involve self-dealing or conflict of interest situations, resulting in the unavailability of the business judgment rule protection.

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Under the current law, a self-dealing situation arises only when it involves a direct financial interest of the manager, but not in cases of indirect or intangible interest where the manager is motivated by her own prestige and reputational benefit (for example, when a director favors a certain constituency group with whom she has a personal alignment or sympathy, when she uses corporate funds to advance an agenda or cause important to her, when she offers corporate support and funding to a party of her political affiliation, or when she makes a corporate donation to a museum or school that will name an exhibition or building after her). In these situations of non-financial conflicts of interests, there should be additional precautions to protect against wrongful use of corporate resources because market forces may not provide a satisfactory solution, as discussed in this paper. In most cases, the market will respond to stakeholder-driven decisions that allegedly destroy shareholder value by stock sales and price declines (exit), through purchase of control (takeovers) or through proxy fights to replace management or advance shareholder proposals (voice). However, in case of controlled companies with dominant shareholders or privately-held companies with no liquidity, the exit, takeover and voice remedies may not be available.

In such circumstances, directors should always conduct a cost-benefit analysis, explain the value created to shareholders from stakeholder-friendly decisions, and disclose in general terms the basis for such decisions. Whenever possible, boards should seek the approval of disinterested directors or shareholders when decisions could reasonably trigger an indirect conflict of interest or personal benefit situation. Without necessarily triggering judicial review under the entire fairness rule, courts should be permitted to review the facts and circumstances, make a proportionality assessment, and require compliance with procedural prophylactic steps. The author advocates for a system that would require managers to engage in good faith attempts to identify all constituencies involved, to quantify and reconcile the impacts on each constituency, and to explain why they believe that a decision favoring a nonshareholder constituency ultimately brings long-term value to the corporation and the shareholders. The author also supports a system of enhanced disclosure whereby the market, in possession of clear and verifiable cost-benefit analysis information, would curb companies and managers taking excessively stakeholder-friendly decisions at the cost of the trading price of their shares. Finally, clarity about the purpose of a given corporation is paramount, and companies should describe in their organizational documents if they intend to serve the interests of stakeholders other than shareholders, and the process by which the board will mediate prospective conflicts between stakeholders and shareholders.

Clear, well-structured, and properly executed stakeholder-friendly decisions will likely create long-term value to shareholders and are germane to the shareholder primacy doctrine, but impulsive, poorly structured decisions taken by managers seeking personal reputation and recognition will often translate into destruction of shareholder value and therefore should be deterred by the law.

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INTRODUCTION

There has been a growing trend in the past decade in favor of protecting stakeholders' interests in businesses and corporate decisions, with companies engaging in corporate social responsibility (CSR) initiatives and adopting practices that consider environmental, social, and governance (ESG) factors alongside financial performance, two acronyms that have gained popularity in recent years.[1]

The shareholder primacy versus stakeholder capitalism[2] conflict represents a fundamental debate about the purpose of a corporation. These two perspectives offer contrasting views on whether a company should primarily serve the interests of its shareholders or consider the broader spectrum of stakeholders in its decision-making process. It is no exaggeration that the court in *TW Services, Inc. v. SWT Acquisition Corp.,*[3] stated what it saw as "the most fundamental issue" in corporate law: "to what interest does the board look in resolving conflicts between interests in the corporation that may be characterized as 'shareholder long-term interests' or 'corporate entity interests' or 'multi-constituency interests' on the one hand, and interests that may be characterized as 'shareholder short term interests' or 'current share value interests' on the other?"

Shareholder primacy asserts that the primary responsibility of a corporation is to maximize shareholder value, and corporate decisions should be made with the primary aim of increasing shareholder wealth.[4] An overly narrow focus on shareholder value is often criticized because it may lead to short-term decision-making, neglecting the long-term sustainability of the business and potentially disregarding the interests of other stakeholders. Stakeholder capitalism, by its turn, posits that a corporation has a broader responsibility to consider the interests of all stakeholders, including employees, customers, suppliers, local communities, and the environment, and all corporate decisions should be made with the aim of creating value for all stakeholders, not just shareholders.[5] This approach often involves a more

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[1] A 2004 report from the United Nations titled "Who Cares Wins" carried what is widely considered the first mainstream mention of ESG in the modern context. *See* THE GLOBAL COMPACT, WHO CARES WINS: CONNECTING FINANCIAL MARKETS TO A CHANGING WORLD (2004), https://www.unepfi.org/fileadmin/events/2004/stocks/who_cares_wins_global_compact_2004.pdf [https://perma.cc/N8FH-CSFS].

[2] In this article, we refer to "stakeholder capitalism" or "stakeholderism" as a corporate model that defines the corporate purpose and managers' fiduciary duties as including an explicit and substantial weight on stakeholder interests to the same degree or even higher than shareholders' interests. Although shareholders can be considered as one class of stakeholders, when we refer to "stakeholders" we are referring to people or interest groups other than the shareholders, who have explicit or implicit contractual relationships with the firm and are affected by the firm's activities and externalities.

[3] No. CIV.A. 10298, 1989 WL 20290, at *12 n.5 (Del. Ch. Mar. 2, 1989).

[4] *See* KLAUS SCHWAB & PETER VANHAM, STAKEHOLDER CAPITALISM: A GLOBAL ECONOMY THAT WORKS FOR PROGRESS, PEOPLE AND PLANET (2021).

[5] *Id.*

comprehensive assessment of the social and environmental impact of business activities.

In many cases, but not always, it will be possible to reconcile such goals with decisions that, notwithstanding reducing profit in the short-term, generate shareholder value in the long-term. Often times, however, it is not possible to satisfy the interests of shareholders and stakeholders, at least not without some compromise, and trade-offs are inevitable. The debate between stakeholder and shareholder capitalism cannot be resolved by saying that what is best for all stakeholders in the long run is necessarily best for all shareholders. That is wishful thinking, as noted by more skeptical authors.[6] In those situations, what is expected from directors and executive officers, who are fiduciaries of the corporation, are hired and fired by the shareholders, and have their performance and compensation measured by earnings and stock appreciation? On the other hand, companies are legal fictions operating under a social license and managers are individuals with moral and ethical standards, living in a society with many problems unsolved by the government, who feel that business organizations have commitments with other constituencies since they produce externalities. What is the current law relating to the fiduciary duties of management in decisions involving profit sacrifice in the pursuit of environmental or social-friendly decisions? What should the law be?

Consider the following hypotheticals and real-life examples:

Company A operates a plant in the United States, where cost of labor is higher and employment regulation is much stricter than other countries. The board receives strong and well-documented evidence from consultants that, by moving the plant to a developing country with lower cost of labor and weaker employee protection, Company A's profit margin would increase by 20%. However, because the current plant is located in a small town very dependent on its operations, closing down the plant would result in massive unemployment, social concerns, and loss of taxes. What should the board do?

For decades on end, U.S. firms have been shifting their production facilities abroad in pursuit of cheaper materials and labor. In November 2018, for example, automaker General Motors announced the closing of three plants in the United States and Canada, laying off 8,000 employees (15% of its employees in America), and decided to start building certain cars from its plant in Mexico instead. On the date of the announcement, General Motor's stock price rose nearly 6%, signaling investors' approval of the cost cuts.[7] In the mid-1990s, Johnson & Johnson decided to relocate its protective equipment production to Asia in a bid to cut costs, and had to let go 250

[6] VIVEK RAMASWAMY, CAPITALIST PUNISHMENT: HOW WALL STREET IS USING YOUR MONEY TO CREATE A COUNTRY YOU DIDN'T VOTE FOR (2023).

[7] *GM to Halt Production at 5 Plants in U.S. and Canada, Cutting up to 14K Jobs*, CBS NEWS (Nov. 26, 2018, 6:50 PM), https://www.cbsnews.com/news/gm-to-close-canadian-plant-and-may-shed-more-jobs/ [https://perma.cc/7HED-8NEC].

employees in its Massachusetts plant.[8]

Company B is a pharmaceutical company and its controlling shareholder and CEO is very religious and has a very conservative opinion against abortion. He decides that Company B should not pursue an abortion pill even when there is ample evidence that such a pursuit would be profitable and increase Company B's margins significantly. On the other extreme, some of Company B's more liberal investors would like Company B not only to produce and sell such a pill, but sell it below cost to help poor pregnant women. How should Company B reconcile these preferences?

In December 2015, Martin Shkreli, former CEO of Turing Pharmaceuticals, decided to approve a 5,000% increase in Daraprim, a drug used in the fight against AIDS and toxoplasmosis, and told the press that he should have increased it even higher.[9] In an interview with Forbes, he justified that his primary responsibility was maximizing profits for company shareholders, which is why he never lowered the price of Daraprim.[10] He said in the interview: "No one wants to say it, no one's proud of it, but this is a capitalist society, capitalist system, capitalist rules. My investors expect me to maximize profits, not to minimize them, or go half or go 70 percent."[11] Is Mr. Shkreli right? Probably not,[12] because he could have refused to raise the drug price without the fear of shareholder suits, alleging that the reputational effects on the company would be very negative, outweighing short-term

[8] An argument can be made that such decision to move plants offshore could have destroyed long-term value. The COVID-19 pandemic caused a major disruption in global supply chains, and U.S. companies experienced a severe shortage of raw materials and suppliers, resulting in production interruptions and increased freight costs. This exposure led many companies to reshore their plants back to the United States. For example, General Motors is reshoring its battery production to Michigan where a new hub for lithium-based products will be created. *See* Sabrina Kessler, *Why US Firms are Reshoring Their Business*, DW (Dec. 8, 2021), https://www.dw.com/en/why-us-companies-are-reshoring-their-business/a-60054515 [https://perma.cc/5KS4-83WC].

[9] Alex Keown, *Turing's Martin Shkreli Says He Should Have Increased the Price of Daraprim Higher than 5,000%*, BIOSPACE (Dec. 4, 2015), https://www.dw.com/en/why-us-companies-are-reshoring-their-business/a-60054515 [https://perma.cc/2L37-NXPL] (citing Forbes, *Martin Shkreli: 'I Would've Raised Prices Higher'*, FORBES (Dec. 3, 2015), https://www.forbes.com/video/4644635141001/martin-shkreli-i-wouldve-raised-prices-higher/).

[10] *Id.*

[11] *Id.*

[12] On May 10, 2023, Vyera Pharmaceuticals (formerly Turing Pharmaceuticals) filed for Chapter 11 bankruptcy. Martin Shkreli was sentenced to seven years in prison for defrauding investors. Mr. Shkreli was found guilty on two counts of securities fraud for duping hedge fund investors in MSMB Capital Management and MSMB Healthcare about the financial performance of the two companies that he operated. And he was convicted of conspiracy to commit securities fraud for manipulating stock shares of Retrophin, a pharmaceutical company he created. Merrit Kennedy, *'Pharma Bro' Martin Shkreli Convicted of Securities Fraud,* NPR (Aug. 4, 2017, 3:31 PM), https://www.npr.org/sections/thetwo-way/2017/08/04/541658697/pharma-bro-martin-shkreli-convicted-of-securities-fraud [https://perma.cc/M9Q4-KFS3].

gains. However, this example demonstrates how complicated the shareholder/stakeholder trade-off can be.

Similarly, the tension is evident in corporate donations, because corporate expenditures receive no monetary short-term financial return. Most of the time, well-structured corporate donations will generate shareholder value by strengthening the company's reputation, improving consumer perception and employees' morale, and therefore will be protected by the business judgment rule.[13] Often times, however, corporate donations are motivated by management's personal preferences, such as personal recognition as great benefactors and statespeople, advancement of a personal political agenda or even outright family favors in quid-pro-quo transactions. As Milton Friedman once said: "Insofar as [manager's] actions in accord with his 'social responsibility' reduce returns to stock holders [sic], he is spending [shareholders'] money."[14]

For example, in 2002, a civil lawsuit filed by the Securities and Exchange Commission (SEC) alleged that the former CEO of Tyco International Ltd., Dennis Kozlowski, donated company money in his own name to Seton Hall University, his alma mater.[15] After a $3 million donation of Tyco's funds, the most prominent academic building on campus was renamed with the Kozlowski name.[16] In August 2005, the New York State Supreme Court found him guilty of stealing hundreds of millions of dollars from the manufacturing conglomerate through improper donations, and Seton Hall University removed his name from the academic building.[17]

In this article, I try to shed light on the true purpose of a for-profit corporation and find more clarity in several related questions. Do managers have a legal duty, an ethical duty, or full discretion in satisfying the interests of nonshareholder constituencies in their corporate decisions? In today's world, can they instead opt to follow a strict shareholder primacy approach, and simply refuse to incorporate environmental, social, and governance considerations in their decisions in the search for profit maximization? Are directors and managers protected by the business judgment rule if they make environmental and social-friendly decisions and engage in corporate

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13 *See infra* Corporate Donations.

14 Keith Davis, *The Case for and Against Business Assumption of Social Responsibilities*, 16 ACAD. OF MGMT. J. 312, 318 (1973) (citing Milton Friedman, *A Friedman Doctrine–The Social Responsibility of Business Is to Increase Its Profits*, N.Y. TIMES (Sept. 13, 1970), https://www.nytimes.com/1970/09/13/archives/a-friedman-doctrine-the-social-responsibility-of-business-is-to.html).

15 Audrey Williams June, *SEC Suit Says Tyco Executive's Gift to Seton Hall U. Illegally Came from Company Funds*, THE CHRONICLE OF HIGHER EDUCATION (Sep. 16, 2002), https://www.chronicle.com/article/sec-suit-says-tyco-executives-gift-to-seton-hall-u-illegally-came-from-company-funds [https://perma.cc/H85H-H5ZH].

16 *Id.*

17 *College Strips off Kozlowski Name Seton Hall University Says the Former Tyco Chief Asked to have His Name Removed,* CNN MONEY (August 18, 2005), https://money.cnn.com/2005/08/18/news/newsmakers/kozlowski_seton/ [https://perma.cc/PQD6-UWWQ].

philanthropy instead of maximizing short-term profit? What is the current law and what should it be?

I am a strong supporter of sustainable capitalism and the application of ESG principles in the way companies operate and allocators of capital invest their money.[18] Since the acronym "ESG" was coined in the beginning of the century,[19] organizations and investors have been allocating massive resources toward improving ESG. More than 90% of S&P 500 companies now publish ESG reports in some form, and the rising profile of ESG has also been plainly evident in investments, with over $2.5 trillion inflows in sustainable funds in 2022.[20] A joint study from McKinsey and NielsenIQ analyzed 600,000 individual product stock-keeping units representing $400 billion in annual retail revenues from 2017 to 2022 and concluded that products making ESG-related claims averaged 28% cumulative growth over the past five-year period, versus 20% for products that made no such claims, indicating that the shift to ESG in production can yield growth and shareholder gain.[21]

Even in a shareholder-focused capitalist view, ESG considerations have become increasingly important, since externalities are increasing and becoming more extreme, requiring urgent coordinated action that cannot be handled by governments alone, at the risk of creating systemic risks impacting all businesses at once. Several companies have performed extremely well in sustainability and corporate social responsibility topics, showing that ESG's success is indeed possible without losing track of financial performance.[22] I do not dispute that shareholders and institutional investors would be free–and have the right incentives–to induce companies

[18] Before we proceed, a disclaimer must be made. This is an article discussing the corporate law principles applied to the apparent conflict of the interests of the shareholders and other nonshareholder constituencies, including the fiduciary duty rules addressing the principal/agent problem in the shareholder/management relationship. This is not an article on politics or social studies.

[19] In the environmental category, topics are normally climate change, greenhouse gas emissions, air pollution, water and wastewater management, waste and circular economy, biodiversity and deforestation. In the social axis, labor practices, health and safety, income inequality, diversity and inclusion and community relations. In governance, business ethics, data security, consumer protection, corruption and governance structure. Before ESG, the term used in the prior century was "corporate social responsibility", or CSR.

[20] Lucy Pérez et al., *Does ESG Really Matter–and Why*, MCKINSEY Q. (Aug. 10, 2022), https://www.mckinsey.com/capabilities/sustainability/our-insights/does-esg-really-matter-and-why#/ [https://perma.cc/6JCJ-5XEV].

[21] Sherry Frey et al., *Consumers Care About Sustainability—and Back it up with Their Wallets*, MCKINSEY & COMPANY & NIELSEN IQ (2023), https://www.mckinsey.com/industries/consumer-packaged-goods/our-insights/consumers-care-about-sustainability-and-back-it-up-with-their-wallets [https://perma.cc/TZ6T-SC8W]).

[22] *See*, *e.g.*, Oliver D. Hart & Luigi Zingales, *Companies Should Maximize Shareholder Welfare Not Market Value*, Working Paper No. 267, University of Chicago Booth School of Business & Stigler Center for the Student of the Economy and the State (July 2017), https://hdl.handle.net/10419/262669 [https://perma.cc/9MXR-LT27].

to provide benefits to stakeholders, but I question whether the proper way would be through a change of law or the rebalancing of the fiduciary duty of directors and officers.[23]

While corporate ESG certainly helps reduce inequalities and externalities produced by business organizations, it nonetheless receives criticism for its flaws in capital allocation, measurement and disclosure, financial performance, and distraction from the need of government regulation. After all, sustainable business practices generally lead to higher costs,[24] and a firm's ability to pass these costs on to consumers is restricted, since the majority of consumers still decides whether to choose cheaper alternatives or not to purchase at all. This leads to a commercial conundrum where the cost can instead be absorbed by the firm, possibly resulting in a hit on profits in some cases.[25]

I. SETTING THE STAGE: THE SHAREHOLDER PRIMACY, THE STAKEHOLDER PRIMACY, AND THEIR VARIATIONS

A. Historical Evolution

Historically, the corporate form and the notion of limited liability were directly linked to the notion of public benefit, and limited liability was a legal privilege that only public interest could justify.[26] The limited liability rule would be seen as a legal favor "conferred by society, in return for which society would demand socially responsible corporate behavior."[27] Many large corporations formed a few centuries ago were created to develop infrastructure and large projects to provide utilities to the population in a quasi-government fashion, like roads, canals, railroads, marine international trade, and banks. The legal design of these companies was intended to achieve good and abundant service at reasonable prices, not necessarily to

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[23] *See* Richard A. Epstein, *The Excessive Ambitions of Stakeholder Ideology*, 77 BUS. LAW. 755, 757 (2022) ("I see no reason to abandon the traditional shareholder primacy rule, which has been responsible for the accumulation of huge wealth in the United States, to the benefit not only of corporate shareholders but, derivatively, to the other constituencies with whom corporations interact—employees, suppliers, customers, and the larger social fabric.").

[24] According to the UN Conference on Trade and Development, "[t]he cost of achieving ambitious sustainable development targets is estimated at between $5.4 and $6.4 trillion per year between now and 2030." *Annual cost for reaching the SDGs? More than $5 trillion*, UN NEWS (Sep. 19, 2023), https://news.un.org/en/story/2023/09/1140997 [https://perma.cc/6ASX-SLUQ].

[25] Marco Bertini et al., *Can We Afford Sustainable Business?*, MIT SLOAN MGMT. REV. 1 (2021).

[26] *See* Frederick G. Kempin, Jr., *Limited Liability in Historical Perspective*, 4 AM. BUS. L. ASS'N BULL. 11, 13–14 (1960); *see also* Shaw Livermore, *Unlimited Liability in Early American Corporations*, 43 J. POL. ECON. 674, 674 (1935).

[27] Stephen M. Bainbridge, *In Defense of The Shareholder Wealth Maximization Norm: A Reply to Professor Green*, 50 WASH. & LEE L. REV. 1423, 1428 (1993).

maximize investment returns.[28]

That conception was then gradually abandoned with the enactment of incorporation acts in the United States and worldwide that permitted incorporation of corporate entities with limited liability without prior authorization by the government. In the beginning of last century, the notion that the main purpose of business corporations was to make profit for shareholders was largely accepted. In *Dodge v. Ford Motor Co.,* for example, the Michigan Supreme Court recognized in 1919 that "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 . . . ."[29]

However, a competing notion of corporate purpose started to develop and received support from scholars, legal theorists, leaders, and the business community.

In the classic debate between Merrick Dodd and Adolf Berle in the 1930s, Berle defended the shareholder primacy theory, arguing that corporate law was essentially a variant of trust law, in which corporate managers owed fiduciary duties to manage the corporation in the interests of the shareholders, the beneficiaries.[30] Berle's argument was based on the notion that shareholders had property rights over the corporation by means of their shares.

On the other hand, Dodd argued that managers owed obligations to a wider set of beneficiaries and "should concern themselves with the interests of employees, consumers, and the general public, as well as of the stockholders,"[31]—the entity having "a social service as well as a profit-making function."[32]

The Berle-Dodd debate has continued for decades, with important supporters of stakeholderism defending the notion that the purpose of the corporation should be reoriented to stakeholder welfare for the benefit of other nonshareholder constituencies, such as employees, suppliers, local communities, the environment, and many others.

Furthermore, the numerous cases of hostile takeovers in the 1980s and 1990s prompted the enactment of antitakeover legislation, and most states passed statutes explicitly allowing directors to consider the interests of other constituencies when making a decision (both in the context of an acquisition

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[28] Lynn A. Stout, *The Shareholder Value Myth*, EUROPEAN FINANCIAL REVIEW (Apr. 30, 2013), https://www.europeanfinancialreview.com/the-shareholder-value-myth-2/ [https://perma.cc/S74B-YJ3V].

[29] 170 N.W. 668, 684 (Mich. 1919).

[30] Adolf Berle, *Corporate Powers as Powers in Trust*, 44 HARV. L. REV. 1049, 1074 (1931).

[31] E. Merrick Dodd, *For Whom are Corporate Managers Trustees?*, 45 HARV. L. REV. 1145, 1156 (1932).

[32] *Id.* at 1148.

of the company or, more generally, on regular management of the business).[33]

As proponents of stakeholder-centric capitalism consistently gained force in the past decades, the world's largest institutional investors and asset managers,[34] such as BlackRock,[35] Vanguard,[36] and State Street, which control between 15-30 percent of every public company in the United States,[37] have voiced strong support to defending nonshareholder interests, but make clear that such goal should be pursued only if the interests of their clients (shareholders) are cared for first.

As noted by William T. Allen, Chancellor of the Delaware Court of Chancery, "[t]wo inconsistent conceptions have dominated our thinking about corporations . . . [and] each conception could claim dominance for a particular period, or among one group or another, but neither has so commanded agreement as to exclude the other from the discourses of law or the thinking of business people. . . . [W]e have been schizophrenic on the nature of the corporation . . . ."[38] We come to a critical juncture where the legal community, policy makers, and investors need to develop a compromise in the middle of the shareholderism-stakeholderism spectrum.

B. Shareholder Primacy—Context and Definitions

Under the more traditional understanding of corporate law, unless modified by statute, fiduciary duties require corporate officials to further the interests of shareholders, and thus require them to maximize shareholder value. The sole purpose of business corporations, the argument goes, is and should be profit-maximization.[39]

Shareholder primacy is based primarily on the view that the corporation is the private property of its stockholder-owners. Seen under a contract

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[33] *See infra* The Constituencies Statutes.

[34] Lucian Bebchuk & Scott Hirst, *The Specter of the Giant Three*, 99 B.U. L. REV. 721, 732–37 (2019).

[35] Barbara Novick, *A Fundamental Reshaping of Finance*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Jan. 16, 2020), https://corpgov.law.harvard.edu/2020/01/16/a-fundamental-reshaping-of-finance/ [https://perma.cc/33ZV-TE5B].

[36] Vanguard claims that they "believe our approach strikes the appropriate balance between corporate responsibility and our fiduciary obligations." *Policies and Guidelines*, VANGUARD, https://www.vanguard.com.au/personal/en/investment-stewardship-policies-and-guidelines/isp-tab-environmental-social-tab [https://perma.cc/8Z79-XME4] (last visited Feb. 8, 2021).

[37] Bebchuk & Hirst, *supra* note 34, at 734. *See also* Jill E. Fisch et al., *The New Titans of Wall Street: A Theoretical Framework for Passive Investors*, 168 U. PA. L. REV. 17, 62–65 (2019).

[38] William T. Allen, *Our Schizophrenic Conception of the Business Corporation*, 14 CARDOZO L. REV. 261, 264, 280 (1993).

[39] Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733, 736 (2005); Jonathan R. Macey, *An Economic Analysis of the Various Rationales for Making Shareholders the Exclusive Beneficiaries of Corporate Fiduciary Duties*, 21 STETSON L. REV. 23, 23–24, 41 (1991).

model, the corporation's purpose would be to advance the purpose of its owners. Based on a famous article by Michael Jensen and William Meckling in the 1976 Journal of Financial Economics, the basic premises of the shareholder primacy doctrine can be summarized as follows: (i) shareholders own the company and are "principals" with original authority to manage the corporation's business and affairs; (ii) managers are delegated decision-making authority by the corporation's shareholders and thus are their "agents"; (iii) as agents of the shareholders, managers are required to conduct the corporation's business in accordance with the shareholders' desires; and (iv) shareholders want the business conducted in a way that maximizes their own economic results.[40]

In summary, it embraces the idea that shareholders have the priority interest in both economics and governance of the corporation, and ultimately instruct the board to manage the corporation solely for the purpose of maximizing shareholder wealth. Corporate governance scholars have stated that "a foundational concept of corporate law and corporate governance is the principle of shareholder primacy"[41], while economists generally agree that corporate managers should maximize shareholder wealth since "corporations are wealth-producing socioeconomic legal constructs."[42] The economic function of a firm would be to organize and rationalize the shareholders' capital, and businesses can best contribute to the public good by paying taxes, hiring employees, and providing goods and services.

The most famous enunciation of that principle comes from Milton Friedman's famous article in the New York Times Magazine in 1970. He explains that a corporate executive is the employee of the owners of a company and has a direct responsibility to his employers. Accordingly, "[t]hat responsibility is to conduct the business in accordance with their desires, which will generally be to make as much money as possible while conforming to the basic rules of the society, both those embodied in law and those embodied in ethical custom."[43]

It is not clear, however, if shareholder primacy is actually the law,[44] or just a social norm that forms the bedrock of corporate law, a principle that "weaves through a series of rules of corporate law and the architecture of the

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[40] *See* Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. OF FIN. ECON. 305 (1976).

[41] Robert J. Rhee, *A Legal Theory of Shareholder Primacy*, 102 MINN. L. REV. 1951, 1952 (2018).

[42] *Id.*

[43] Milton Friedman, *A Friedman Doctrine–The Social Responsibility of Business is to Increase Its Profits*, N.Y. TIMES (Sept. 13, 1970) https://www.nytimes.com/1970/09/13/archives/a-friedman-doctrine-the-social-responsibility-of-business-is-to.html [https://perma.cc/R92E-FHZ3].

[44] We believe that shareholder primacy is indeed the law, but it is difficult to find the exact locus of law, either a well-established body of case law or a specific statute imposing a duty to comply with shareholder primacy. *See* David G. Yosifon, *The Law of Corporate Purpose*, 10 BERKELEY BUS. L.J. 181 (2014).

corporate and market systems."[45]

The strongest case cited in support of a duty to maximize profit is *Dodge v. Ford Motor Co.,*[46] a 1919 case from Michigan involving Henry Ford and the Dodge brothers, shareholders of the Ford Motor Company, where Mr. Ford refused to distribute dividends from large retained earnings, and the Dodge brothers sought a court order to force Mr. Ford to effect such dividend payment. Mr. Ford justified his business decision not on a shareholder value perspective, but on his personal philosophy that a corporation should "employ still more men, to spread the benefits of this industrial system to the greatest possible number, to help them build up their lives and their homes."[47] The Michigan Supreme Court rejected this argument and said:

> 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 a reduction of profits, or to the non distribution of profits among stockholders in order to devote them to other purposes.[48]

In *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, the Delaware Supreme Court decided that, in an auction situation for the purchase of the company, "[a] board may have regard for various constituencies in discharging its responsibilities, provided there are rationally related benefits accruing to the stockholders."[49]

Later, in 1998, the Delaware courts recognized in *Malone v. Brincat*[50] the traditional model of the nature of the corporation that sees shareholders as owners, explaining that "one of the fundamental tenets of Delaware corporate law provides for a separation of control and ownership. The board of directors has the legal responsibility to manage the business of a corporation for the benefit of its shareholder owners."[51]

Another case giving support to shareholder primacy is *eBay Domestic Holdings, Inc. v. Newmark*.[52] In an attempt to stop eBay's plan to acquire

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[45] Rhee, *supra* note 41, at 1967. Robert Rhee has conducted a comprehensive review of case law from 1900 to 2016 and concludes that shareholder primacy is not law in the sense of a "rule–sanction" command imposed by statutes or explicit court decisions. However, he has identified that such reasoning appears frequently in court decisions, and the pervasive judicial acceptance of such a principle can legitimize it as a rule and thus impose a strong internal sense of obligation.

[46] *See* 170 N.W. 668 (Mich. 1919).

[47] *Id.* at 683.

[48] *Id.* at 684.

[49] 506 A.2d 173, 182 (Del. 1986).

[50] 722 A.2d 5, 9 (Del. 1998).

[51] *Id.*

[52] 16 A.3d 1, 34–35 (Del. Ch. 2010).

Craigslist, Craigslist's board adopted a poison pill arguing that it was necessary to protect Craigslist's social values and community-centric corporate culture, which would be threatened by the acquisition of the corporate giant eBay. There, the court stated:

> Having chosen a for-profit corporate form, the Craigslist [sic] directors are bound by the fiduciary duties and standards that accompany that form. Those standards include acting to promote the value of the corporation for the benefit of its stockholders. The "Inc." after the company name has to mean at least that. Thus, I cannot accept as valid for the purposes of implementing the Rights Plan a corporate policy that specifically, clearly, and admittedly seeks not to maximize the economic value of a for-profit Delaware corporation for the benefit of its stockholders . . . . Directors of a for-profit Delaware corporation cannot deploy a rights plan to defend a business strategy that openly eschews stockholder wealth maximization—at least not consistently with the directors' fiduciary duties under Delaware law.[53]

A few years later, Vice Chancellor Travis Laster reinforced the argument:

> [B]y increasing the value of the corporation, the directors increase the share of value available for the residual claimants. Judicial opinions therefore often refer to directors owing fiduciary duties "to the corporation and its shareholders." This formulation captures the foundational relationship in which directors owe duties to the corporation for the ultimate benefit of the entity's residual claimants. Nevertheless, "stockholders' best interest must always, within legal limits, be the end. Other constituencies may be considered only instrumentally to advance that end."[54]

This discussion surfaces in the laws governing trusts, where the principal-agent tension is evident.[55] There, one of the fundamental principles is the *sole interest rule*, which mandates that the trustees must "administer the trust solely in the interest of the beneficiaries."[56] The Supreme Court has

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[53] *Id.* at 34-35.

[54] *In re* Trados Inc. S'holder Litig., 73 A.3d 17, 36–37 (Del. Ch. 2013) (quoting 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)).

[55] There are important differences between the legal regimes applicable to trusts, which are basically contractual arrangements, and corporations. The argument is presented by way of analogy only.

[56] John H. Langbein, *Questioning the Trust Law Duty of Loyalty: Sole Interest or Best Interest?*, 114 YALE L. J. 929 at 981 (citing RESTATEMENT (SECOND) OF TRUSTS § 170(1)). *See also* Uniform Trust Code 802(a) (2000) ("No form of so-called 'social investing' is consistent with the duty of loyalty if the investment activity entails sacrificing the interest of trust beneficiaries in favor of the interests of persons supposedly benefitted by pursuing the particular social cause").

held in 1985 that a pension plan manager "shall discharge his duties with respect to a plan solely in the interest of participants and beneficiaries and for the exclusive purpose of providing benefits to participants and their beneficiaries."[57] In 2014, the Supreme Court rejected the argument that pension plan managers would be allowed to consider nonpecuniary interests of trustees, rather they must act solely and exclusively to maximize the retirees' financial benefits.[58] Under the sole interest rule, even "mixed-motive" investing is unlawful.[59]

As explained by Max Schanzenbach and Robert H. Sitkoff, "a trustee's use of ESG factors, if motivated by the trustee's own sense of ethics or to obtain collateral benefits for third parties, violates the duty of loyalty."[60] They properly distinguish ESG investments between "collateral benefits ESG" and "risk-return ESG," and conclude that ESG investment is permissible only if two conditions are satisfied: (1) the trustee reasonably concludes that ESG investing will benefit the beneficiary directly by improving risk-adjusted return; and (2) the trustee's exclusive motive for ESG investing is to obtain this direct benefit, not societal, political or religious concerns.[61] For example, a decision to boycott the fossil fuel industry through negative screening with the goal to reduce pollution would be illegal, but if such decision is intended to avoid litigation and regulatory risks, thus improving risk-adjusted returns, then such decision would be permissible and encouraged, consistent with the fiduciary duties of loyalty and prudence.

Scholars defending stakeholderism argue that the shareholder primacy canonical is simply wrong and go further: "the so-called stockholder wealth maximization principle is not just legally erroneous, but socially harmful."[62] They argue that, as a matter of statutory law, none of the 50 states in America has a corporate statute providing that the sole purpose of corporations is maximizing profits for shareholders, but, to the contrary, many statutes permit corporations to sacrifice profits in the public interest.

Also, according to such scholars, managers have never had an enforceable legal duty to maximize corporate profits; such a duty would be unenforceable on its own term because the business judgment rule would defeat any claims based on a failure to maximize profit. As put by Robert

[57] Cent. States, Se. & Sw. Areas Pension Fund v. Cent. Transp., Inc., 472 U.S. 559, 570–71 (1985) (quoting 29 U.S.C. §1104(A)(1)(a)).

[58] Fifth Third Bancorp v. Dudenhoeffer, 573 U.S. 409, 420–421 (2014).

[59] Max Schanzenbach & Robert Sitkoff, *Reconciling Fiduciary Duty and Social Conscience: The Law and Economics of ESG Investing by a Trustee*, 72 STAN. L. REV. 381, 401 (2020).

[60] *Id.* at 381.

[61] *Id.* at 382.

[62] Leo E. Strine, Jr. et al., *Caremark and ESG, Perfect Together: A Practical Approach to Implementing an Integrated, Efficient, and Effective Caremark and EESG Strategy*, 106 IOWA L. REV. 1885, 1902 (2021).

Rhee:

> Courts have held that shareholders cannot challenge a board's decision on the specific reasons that, for example, the company paid its employees too much; it failed to pursue a profit opportunity; it did not maximize the settlement amount in a negotiation; or it failed to lawfully avoid taxes. Textbook cases show that courts have rejected shareholders' attempts to interfere with the board's decisions on the argument that their views of business or strategy would have maximized corporate value.[63]

In fact, in *In re Rexene Corp. Shareholders Litigation*, the court stated that "[b]ad faith will be inferred where 'the decision is so beyond the bounds of reasonable judgment that it seems essentially inexplicable on any [other] ground.'"[64] Bad faith has also been defined as irrationality, when a board's decision was so *egregious* or *irrational* that it could not have been based on a valid assessment of the corporation's best interests.[65] The Delaware Court of Chancery has held that "[w]hen director decisions are reviewed under the business judgment rule, [the court] will not question rational judgments about how promoting non-stockholder interests—be it through making a charitable contribution, paying employees higher salaries and benefits, or more general norms like promoting a particular corporate culture—ultimately promote stockholder value."[66]

Case law is clear that liability for violating a duty to act in good faith attaches only in extreme situations, bordering irrationality, and the courts will likely abstain from second-guessing decisions prioritizing nonshareholder interests at the expense of shareholder interests, as long as there is a minimal rational justification.

Under the business judgment rule, management has always had legal discretion to sacrifice corporate profits in the public interest, and commanding a board to maximize profit (or shareholder value) through threat of litigation would be inefficient in terms of enforcement, since business decisions would ultimately have to be made by courts. In other words, "[t]he directors, of course, retain substantial discretion, outside the context of a change of control, to decide how best to achieve that goal and the appropriate

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63 Rhee, *supra* note 41, at 1962. *See also* Kamin v. Am. Express Co., 383 N.Y.S.2d 807, 815 (N.Y. App. Div. 1976); Shlensky v. Wrigley, 237 N.E.2d 776, 779-80 (Ill. App. Ct. 1968).

64 1991 WL 77529, at *4 (Del. Ch. 1991) (quoting *In re* J.P. Stevens & Co., Inc. S'holders Litig., 542 A.2d 770, 780 (Del. Ch. 1988)).

65 Brehm v. Eisner, 746 A.2d 244, 264 (Del. 2000) (en banc). *See also* White v. Panic, 783 A.2d 543, 554 n.36 (Del. 2001) (en banc) ("To prevail on a waste claim or a bad faith claim, the plaintiff must overcome the general presumption of good faith by showing that the board's decision was so egregious or irrational that it could not have been based on a valid assessment of the corporation's best interests.").

66 eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 33 (Del. Ch. 2010).

time frame for delivering those returns."[67] Indeed, as Einer Elhauge notes, "this discretion [to sacrifice profits] could not be eliminated without destroying the business judgment rule that is the bedrock of corporate law."[68]

It is well-settled policy that the business judgment rule has a vital role in corporate law, because through it, "Delaware law encourages corporate fiduciaries to attempt to increase stockholder wealth by engaging in those risks that, in their business judgment, are in the best interest of the corporation 'without the debilitating fear that they will be held personally liable if the company experiences losses.'"[69]

In this context, shareholder primacy seems "a managerial choice – not a legal requirement."[70] However, despite not being a legally enforceable duty imposed by law, the principle of shareholder value maximization in corporate law cannot be ignored. As Leo Strine, Jr., former chief justice of the Delaware Supreme Court, stated, "corporate law requires directors, as a matter of their duty of loyalty, to pursue a good faith strategy to maximize profits for the stockholders,"[71] and "a clear-eyed look at the law of corporations in Delaware reveals that, within the limits of their discretion, directors must make stockholder welfare their sole end," indicating that Delaware corporations should only consider stakeholder interests "as a means of promoting stockholder welfare."[72]

Citing *Katz v. Oak Industries Inc.*,[73] some scholars have developed a view that, even absent an express rule to maximize shareholder profit, the board has a duty to *prefer* the interest of shareholders over creditors. In *Katz*, bondholders complained about an allegedly coercive exchange offer that had been launched with the purpose to "benefit Oak's common stockholders at the expense of the Holders of its debt."[74] The court held that:

> It is the obligation of directors to attempt, within the law, to maximize the long-run interests of the corporation's stockholders; that they may sometimes do so "at the expense" of others (even assuming that a transaction which one may refuse to enter into can meaningfully be said to be at his expense) "does not for that reason constitute a breach

[67] Leo E. Strine, Jr., *Our Continuing Struggle with the Idea That For-Profit Corporations Seek Profit*, 47 WAKE FOREST L. REV. 135, 155 (2012).

[68] Elhauge, *supra* note 39, at 738.

[69] *In re* Goldman Sachs Grp., Inc. S'holder Litig., 2011 WL 4826104, at *23 (Del. Ch. 2011) (quoting *In re* Citigroup Inc. S'holder Derivative Litig., 964 A.2d 106, 139 (Del. Ch. 2009)).

[70] Stout, *supra* note 28.

[71] Strine, *supra* note 67, at 155.

[72] 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, 768 (2015).

[73] 508 A.2d 873 (Del. Ch. 1986).

[74] *Id.* at 878.

of duty."[75]

Similarly, and also citing Katz, when assessing a conflict between the interests of common shareholders and preferred shareholders in *Equity-Linked Investors, L.P. v. Adams*, the court ruled in favor of the common shareholders and held that:

> The special protections offered to the preferred are contractual in nature. The corporation is, of course, required to respect those legal rights. . . . [G]enerally it will be the duty of the board, where discretionary judgment is to be exercised, to prefer the interests of common stock . . . to the interests . . . of preferred stock, where there is a conflict.[76]

In *Bandera Master Fund L.P. v. Boardwalk Pipeline Partners, LP*, the court stated that:

> When exercising their authority, directors must seek "to promote the value of the corporation for the benefit of its stockholders." "It is, of course, accepted that a corporation may take steps, such as giving to charitable contributions or paying higher wages, that do not maximize profits currently. They may do so, however, because such activities are rationalized as producing greater profits over the long-term." Decisions of this nature benefit the corporation as a whole and, by increasing the value of the corporation, increase the share of value available for the residual claimants. Nevertheless, "Delaware case law is clear that the board of directors of a for-profit corporation . . . must, within the limits of its legal discretion, treat stockholder welfare as the only end, considering the other interests only to the extent that doing so is rationally related to stockholder welfare."[77]

Some scholars have been more vocal about the law of corporate purpose. Stephen Bainbridge, for example, states that "[a]t least in Delaware, the law of corporate purpose is well settled in favor of shareholder wealth maximization. Directors have a fiduciary duty to sustainably maximize shareholder wealth over such time horizon as the board deems fit."[78] In the case of corporations with complex capital structures, with common stock, preferred stock, and debt, when the interests of these different classes of investors diverge, the duties of the board are to act for the benefit of the

75 *Id.* at 879.

76 705 A.2d 1040, 1042 (Del. Ch. 1997).

77 No. 2018-0372-JTL, 2019 WL 4927053 at *14 (Del. Ch. Oct. 7, 2019).

78 Stephen Mark Bainbridge, *Corporate Purpose in a Populist Era,* (UCLA Sch. of L., Law & Econ. Research Paper No. 18-09, 2018), http://dx.doi.org/10.2139/ssrn.3237107 [https://perma.cc/B8U9-2HN2].

common stockholders.[79]

Certain extreme situations of stakeholder-centric decisions contrary to shareholders' interests may even qualify under the doctrine of corporate waste, since "a board may not deliberately choose to waste the corporation's assets by dedicating them to some explicit purpose other than the promotion of shareholder value, which may be seen as mutually exclusive or even directly opposed to promoting shareholder value."[80]

However, the doctrine of corporate waste is also not a sufficient remedy to curb decisions excessively focused on stakeholders' interests. According to Lewis' court, "waste entails an exchange of corporate assets for consideration so disproportionately small as to lie beyond the range at which any reasonable person might be willing to trade"[81] and "[m]ost often the claim is associated with a transfer of corporate assets that serves no corporate purpose; or for which no consideration at all is received. Such a transfer is in effect a gift."[82]

Now, in practical terms, commentators have argued that shareholder primacy is irrelevant in actual business management[83]—and they have a valid point. A corporate manager will have broad decision-making authority so long as she acts informedly, disinterestedly, and in good faith, and let's be honest, any rational decision can be justified on some abstract benefit to the long-run interest of the corporation and shareholders.

C. Stakeholder Primacy—Context and Definitions

We saw above that the more traditional view of corporate laws in the middle of last century was that the sole purpose of business corporations should be profit-maximization and shareholder value.

Scholars defending stakeholderism have argued that this understanding of corporate law is simply wrong. First, they argue that shareholders do not have ownership rights over the corporation (like they have on a house or a car)—they may have ownership of the shares representing the capital stock of the corporation, but not of the corporation itself.[84] They are beneficiaries of the corporation's activities, but they do not enjoy access to the corporate premises or use of the corporation's assets, which is normally associated with

[79] Edward Rock, *For Whom is the Corporation Managed in 2020?: The Debate Over Corporate Purpose* (Eur. Corp. Governance Inst., Law Working Paper No. 515/2020, 2020), https://ssrn.com/abstract=3589951 [https://perma.cc/3GR9-3U54].

[80] Kyle Westaway & Dirk Sampselle, *The Benefit Corporation: An Economic Analysis with Recommendations to Courts, Boards, and Legislatures*, 62 EMORY L. J. 999, 1026 (2013).

[81] Lewis v. Vogelstein, 699 A.2d 327, 336 (Del. Ch. 1997).

[82] *Id.*

[83] *See generally,* LYNN STOUT, THE SHAREHOLDER VALUE MYTH: HOW PUTTING SHAREHOLDERS FIRST HARMS INVESTORS, CORPORATIONS, AND THE PUBLIC (1st ed. 2012).

[84] Martin Lipton et al, *Was Milton Friedman Right about Shareholder Capitalism?*, Harv. L. Sch. Forum on Corporate Governance, https://corpgov.law.harvard.edu/2021/04/21/was-milton-friedman-right-about-shareholder-capitalism/ [https://perma.cc/H7HU-WV9Y].

property rights. Also, they claim that managers are not agents, but fiduciaries, and not just for the shareholders but also for the corporation itself. Agents have to take orders from the principal, while fiduciaries are expected to make discretionary decisions and exercise independent judgment on behalf of a beneficiary.

Proponents of the stakeholder-centric doctrine typically assert that corporate governance should be treated as a subject of public law and that the separation of ownership and control requires regulation in order to achieve public outcomes unrelated to private profitability.[85]

First, no state in America has a corporate statute that defines the sole purpose of corporations as maximizing profits for shareholders. Contrarily, many statutes allow corporations to sacrifice profits in the public interest. More than that, virtually every state's incorporation statutes give management explicit authority to donate corporate funds for charitable purposes (which could be viewed as an extreme example of profit sacrificing for public interest).

Also, managers would never have had an enforceable legal duty to maximize corporate profits, as we have seen before. Rather, they have always had some ample legal discretion to sacrifice corporate profits in the public interest. In fact, current laws allow profit sacrificing decisions but do limit such sacrifice to a "reasonable" degree of profits, as discussed below.

In fact, case law in the context of takeover bids has also authorized managers to consider "the impact on 'constituencies' other than shareholders (i.e., creditors, customers, employees, and perhaps even the community generally)"[86] and "constituencies other than the shareholders."[87]

More recently, in *Burwell v. Hobby Lobby Stores, Inc.*, the Court held that a business does not need to solely pursue a profit as a matter of state corporate law.[88] Corporations would in fact have a legal basis for being vocal on social issues or in social movements since maximizing shareholder value does not need to be the sole driver of their actions. As Justice Alito wrote, "[w]hile it is certainly true that a central objective of for-profit corporations is to make money, modern corporate law does not require for-profit corporations to pursue profit at the expense of everything else, and many do not do so."[89]

Indeed, as Einer Elhauge notes, "this discretion [to sacrifice profits] could not be eliminated without destroying the business judgment rule that is the bedrock of corporate law."[90] Under the business judgment rule, the courts

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[85] Westaway & Sampselle, *supra* note 80, at 1002-03.

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

[87] Paramount Communications, Inc. v. Time, Inc., 571 A.2d 1140, 1153 (Del. 1990).

[88] 573 U.S. 682, 711-12 (2014).

[89] *Id.*

[90] Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest,* 80 N.Y.U. L. REV. 733, 738 (2005).

will not second-guess the business judgment of managers as to what course of conduct is in the best interests of the corporation as long as those managers do not have a direct conflict (i.e. a personal financial interest). This would be crucial according to Elhauge because "statutes and cases define conflicts of interest to include only 'the financial interests of the director and his immediate family and associates' thus making clear this exception does not apply if the alleged conflict is between the corporation's financial interests and some public interest cause, even if the manager derives a special psychic pleasure from furthering it."[91]

In other words, according to stakeholderism supporters, the mere fact that a director or manager enjoys a personal gain in prestige and reputation from her actions does not represent a conflict of interest sufficient to repeal the application of the business judgment rule. In fact, in *Shlensky v. Wrigley,* where defendant Mr. Wrigley refused to install lights in the Wrigley Field based on "his personal opinions that baseball was a daytime sport," the court refused to investigate Mr. Wrigley's actual motivation, which was irrelevant.[92]

The only case that stakeholderism supporters admit that has apparently ever interfered with the corporate power to sacrifice profits in the public interest was *Dodge v. Ford Motor* discussed above. Although *Dodge v. Ford Motor* continues valid case law, stakeholderism supporters claim that this is an old case, it is "aberrational,[93] clouded with specific facts and circumstances,[94] and that the court did not enjoin the business expansion itself, but only the refusal to distribute dividends without a proper justification, meaning that the court has never expressed a view as to whether benefitting employees and consumers at some expense to shareholders was an acceptable motive. Mr. Ford would have only lost his case because he expressly admitted that his motivation was primarily to sacrifice profits without inquiring into the profitability or business operation. He would probably have won his case if he alleged that, in his business discretion, lowering prices would increase car sales and create goodwill with consumers, thus increasing profits in the long term.

As discussed, courts have allowed decisions that sacrifice corporate

[91] *Id.* at 770.

[92] 95 Ill. App. 2d 173, 176 (1968).

[93] Elhauge, *supra* note 90, at 774.

[94] It seems that Mr. Ford was running for the U.S. Senate at that time, so the court may have taken the view that he was making that decision with a view to capture public opinion to further his own interest in election. Also, another underlying reason could be that he was suspending dividends in order to force the Dodge brothers to sell their stock to him at favorable prices (which eventually happened), or that Mr. Ford was preparing for a fight against the Dodge brothers who had decided to start their own car business (with the dividend suspension Mr. Ford would have arguably deprived them of the necessary capital to do so). *See* Melvin Aron Eisenberg, *Corporate Conduct that Does Not Maximize Shareholder Gain*, 28 STETSON L. REV. 1, 22-25 (1998).

profits to advance stakeholder interests as long as the decision-makers do not have a personal financial interest and offer some conceivable link to a long-term value justification, and such link will always exist by saying, for example, that it creates reputational and goodwill gains with consumers, employees, the neighborhood, other businesses, or government regulators.[95]

As some scholars have put, the correct reading of the shareholder primacy principle should be that directors should not maximize shareholder value, but "satisfice" shareholder value (a word that combines "satisfy" and "suffice" according to Nobel prize winner Herbert A. Simon).[96]

In *Paramount Communications, Inc. v. Time, Inc.*, the court stated that "a board of directors . . . is not under any *per se* duty to maximize shareholder value," and directors would be permitted to consider the interests of "creditors, customers, employees, and perhaps even the community generally."[97]

1. Enlightened Shareholder Value and the New Paradigm

The interaction between a corporation and its stakeholders often times can be mutually beneficial, since corporations create jobs, pay salaries, develop products, offer services, and generate taxes, while stakeholders provide the necessary conditions for the corporations to operate and grow: the government provides the rule of law, property rights, and infrastructure, employees provide labor, consumers, and communities absorb corporate production. Protecting stakeholders' interests will typically lead to long-term shareholder value.

The relationship between firm value and environmental and social factors has empirical support. In general, studies of firm performance find that firms with high environmental and social scores enjoy higher earnings with lower risk than firms with low environmental and social scores.[98] Other studies present evidence that firms can build goodwill through socially responsible activities, which can protect against reputational harm from adverse events.[99]

Prominent economists have defended stakeholderism as a way to create economic return, not to do social justice.[100] Alex Edmans, for example,

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[95] Einer Elhauge, *The Inevitability and Desirability of the Corporate Discretion to Advance Stakeholder Interests*, 106 CORNELL L. REV. 1819 (2021).

[96] Lynn A. Stout, *The Shareholder Value Myth*, EUR. FIN. REV. (2013) (citing HERBERT A. SIMON, ADMINISTRATIVE BEHAVIOR: A STUDY OF DECISION-MAKING IN ADMINISTRATIVE ORGANIZATION (1947)).

[97] 571 A.2d 1140, 1150 (Del. 1990).

[98] *See* Mozaffar Khan et al., *Corporate Sustainability: First Evidence on Materiality*, 91 ACCT. REV. 1697, 1697–700 (2016).

[99] *See* Paul C. Godfrey et al., *The Relationship Between Corporate Social Responsibility and Shareholder Value: An Empirical Test of the Risk Management Hypothesis*, 30 STRATEGIC MGMT J. 425, 441–42 (2009).

[100] REBECCA HENDERSON, REIMAGINING CAPITALISM IN A WORLD ON FIRE, 8, 11 (2020).

reviews a substantial body of empirical evidence and shows a positive correlation between social performance and financial performance.[101] With that assumption, scholars have proposed the "enlightened shareholder value"[102] approach, also referred to as "instrumental shareholderism"[103] in the sense that stakeholders' interests can be considered only as a means to achieve shareholder welfare, and not as an end in itself. This concept has been embraced, for example, by the American Bar Association[104] and the 2006 United Kingdom Companies Act.[105] The UK Companies Act lists non-exhaustive factors that directors should consider in seeking to enhance shareholder value, such as "the interests of the company's employees" and "the impact of the company's operations on the community and the environment," in order "to promote the success of the company for the benefit of its [shareholders]."[106]

"Enlightened shareholder value" definitely sounds better, but is it really different from the traditional shareholder value, if we understand shareholder primacy as the goal for shareholder welfare in the long-term (as opposed to the next quarter earnings and share prices)? It seems that enlightened shareholder value is only a different articulation of the same shareholder value concept. After all, even Milton Friedman, who is known for his strong shareholder primacy position, acknowledged that stakeholder-friendly decisions can sometimes maximize shareholder value.[107]

While it is true that, in most cases, the interests of the shareholders can be satisfied without hurting the interests of stakeholders, this is not always the case. The enthusiasm for the supporters of the "enlightened shareholder value" appears to be grounded in a misperception about how frequent these "win-win situations" are, but, in reality, corporate leaders often face

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[101] ALEX EDMANS, GROW THE PIE: HOW GREAT COMPANIES DELIVER BOTH PURPOSE AND PROFIT, 105–06, 112 (2020).

[102] Virginia Harper Ho, *"Enlightened Shareholder Value": Corporate Governance Beyond the Shareholder-Stakeholder Divide,* 36 J. CORP. L. 1, 60 (2010), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3725725 [https://perma.cc/TM58-6NBB]; *see also* Dorothy S. Lund, *Enlightened Shareholder Value, Stakeholderism, and the Quest for Managerial Accountability*, Research Handbook on Corporate Purpose and Personhood (Pollman & Thompson, eds., 2020), https://ssrn.com/abstract=3725725 [https://perma.cc/3VAL-55XQ].

[103] Lucian A. Bebchuk & Roberto Tallarita, *The Illusory Promise of Stakeholder Governance,* 106 CORNELL L. REV. 91, 108 (2020).

[104] *Other Constituency Statutes: Potential for Confusion*, 45 BUS. LAW. 2253, 2269 (1990) (stating that management can consider nonshareholder interests only to the extent that doing so advances corporate profit).

[105] Companies Act 2006, c. 46, § 172(1) (UK), https://www.legislation.gov.uk/ukpga/2006/46/section/172/data.pdf [https://perma.cc/XH2W-TZZP].

[106] *Id.*

[107] Friedman, *supra* note 43 ("providing amenities to community or to improving its government may make it easier to attract desirable employees, it may reduce the wage bill or lessen losses from pilferage and sabotage or have other worthwhile effects").

significant trade-offs between shareholder and stakeholder interests.[108]

Enlightened shareholder value supporters argue that this approach would provide moral support and legal protection, and effectively encourage, directors who wish to offer benefits to stakeholders at the expense of shareholders. However, because of the strong application of the business judgment rule in practice, corporate leaders do not face any meaningful risk of having to justify such decisions before any court, which could be problematic since there would be no accountability.

Another attempt to reconcile shareholder primacy with stakeholderism is the "New Paradigm" proposed by Martin Lipton, where a corporation's mandate shall "take into account all corporate stakeholders, including communities . . . , society and the economy at large and directs boards to exercise their business judgment within the scope of this broader responsibility" based on the "responsible long-term corporate stewardship" embodied in the statement issued in 2016 by the World Economic Forum.[109] Lipton's formulation of corporate purpose and objective is as follows:

> The purpose of a corporation is to conduct a lawful, ethical, profitable and sustainable business in order to ensure its success and grow its value over the long term. This requires consideration of all the stakeholders that are critical to its success (shareholders, employees, customers, suppliers and communities), as determined by the corporation and its board of directors using their business judgment and with regular engagement with shareholders, who are essential partners in supporting the corporation's pursuit of its purpose. Fulfilling this purpose in such manner is fully consistent with the fiduciary duties of the board of directors and the stewardship obligations of shareholders.[110]

Mindful of that tension, prudent companies have tried to link their ESG initiatives and statements with growth and shareholder value. For example, when CVS announced in 2014 that it would stop selling tobacco products at its stores, notwithstanding a reduction in revenues, it emphasized that the move was a way to do social good and to better "position the company for

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[108] Lucian A. Bebchuk et al., *Does Enlightened Shareholder Value Add Value?*, 77 BUS. LAW 731, 742 (2022).

[109] Martin Lipton, *Beyond Friedman's Doctrine: The True Purpose of the Business Corporation, in Milton Friedman 50 Years Later*, PROMARKET, Sept. 28, 2020, https://www.promarket.org/2020/09/28/friedman-doctrine-true-purpose-corporation-new-paradigm/ [https://perma.cc/M6VZ-6GJZ]; *see also* Martin Lipton, *It's Time to Adopt the New Paradigm*, HARV. L. SCH. F. ON CORP. GOVERNANCE, Feb. 11, 2019, https://corpgov.law.harvard.edu/2019/02/11/its-time-to-adopt-the-new-paradigm/ [https://perma.cc/R4J9-K5QX].

[110] Martin Lipton, *Beyond Friedman's Doctrine: The True Purpose of the Business Corporation, in Milton Friedman 50 Years Later*, PROMARKET, (Sept. 28, 2020), https://www.promarket.org/2020/09/28/friedman-doctrine-true-purpose-corporation-new-paradigm/ [https://perma.cc/M6VZ-6GJZ].

continued growth."[111] Another clear example is Dick's Sporting Goods decision in 2019 to remove assault-style weapons from more than one hundred company stores after seventeen people were gunned down at Marjory Stoneman Douglas High School. Not only did Dick's destroy about five million dollars' worth of weapons in its inventory, but it also forewent future revenues from that line of products.[112]

When BlackRock and other important asset managers support ESG thinking, they often say that it is value-maximizing in the long run and not a sacrifice at all, since it seeks to "create value for and be valued by its full range of stakeholders in order to deliver long-term value for its shareholders" and "[s]takeholder capitalism is all about delivering long-term, durable returns for shareholders."[113] In Vanguard's Policies and Guidelines, Vanguard claims that it "believe[s] our approach strikes the appropriate balance between corporate responsibility and our fiduciary obligations."[114] And the examples go on. General Motors' guidelines state that "shareholders' long-term interests will be advanced by responsibly addressing the concerns of other stakeholders essential to the Company's success, including customers, employees, dealers, suppliers, government officials and the public at large"[115], while Walmart's guidelines acknowledge

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[111] For a retrospective of CVS's initiatives against tobacco products, see CVS Health, *Strengthening Our Commitment to Help End Tobacco Use*, (Sep. 19, 2019), www.cvshealth.com/news/community/strengthening-our-commitment-to-help-end-tobacco-use.html [https://perma.cc/BK4R-EWWA].

[112] Note that such decision has been carefully crafted to not minimize the impact on the business. First, Dick's Sporting Goods did not ban all guns, just assault-style weapons. Dick's CEO Edward Stack explained that getting Dick's out of the gun business altogether would drastically hurt the company, since sports hunting had been a mainstay of its business since the company's earliest days, and that hunters didn't only buy guns, but also hunting coats, boots, socks and other big-ticket items. But that strategy didn't cushion the company entirely. The policy changes costed the company about a quarter of a billion dollars per year. Customers boycotted the company, and more than 60 employees quit. *See* Rachel Siegel, *Dick's Sporting Goods Destroyed $5 Million Worth of Guns*, THE SEATTLE TIMES (Oct. 8, 2019), https://www.seattletimes.com/business/dicks-sporting-goods-ceo-says-overhauled-gun-policies-cost-the-company-a-quarter-of-a-billion-dollars/ [https://perma.cc/L42U-LZX6]. However, Dick's made up for it over time through apparel sales, according to a Harvard Business School *see* Jay Fitzgerald, *Dick's Sporting Goods Followed Its Conscience on Guns—and it Paid Off*, HARV. BUS. SCH. WORKING KNOWLEDGE (Apr. 18, 2022), https://hbswk.hbs.edu/item/dicks-sporting-goods-followed-its-conscience-on-guns-and-it-paid-off [https://perma.cc/AY29-UWFX].

[113] Larry Fink, *2022 Letter to CEOs: The Power of Capitalism*, BLACKROCK, https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter [https://perma.cc/X4SW-L9K5].

[114] Policies and Guidelines, VANGUARD, https://www.vanguard.com.au/ personal/en/investment-stewardship-policies-and-guidelines/isp-tab-environmental-social-tab [https://perma.cc/8Z79-XME4].

[115] General Motors Company Board of Directors Corporate Governance Guidelines, GEN. MOTORS CO. 2 (Aug. 8, 2017), https://pcg.law.harvard.edu/data/BRTPurposeArchive/GM1.pdf [https://perma.cc/NW4J-AQF5].

that "awareness that the Company's long-term success depends upon its strong relationship with its customers, associates, suppliers and the communities, including the global community, in which it operates."[116]

2. The Pluralistic Approach

A different, more problematic, approach is the one that understands that corporate law should treat stakeholder welfare as an end in itself, not merely as a means to shareholder value, and that the welfare of each group of stakeholders is relevant and valuable independently of its effect on the welfare of shareholders. In other words, directors would have a plurality of independent constituencies to serve, and the law would not create a preponderance of shareholder welfare, so that they would be free to freely weigh and balance the interests of the several interest groups.[117] Blair and Stout, for example, argue that directors' main function is to *mediate* among constituencies and decide how to allocate the value created by the corporation between shareholders and stakeholders.[118] Melvin Eisenberg, in analyzing the corporation under his "political model," argues that "the corporation is a political institution whose constituencies are the groups it affects most directly; the corporation is legitimated only if its processes turn on democratic participation by those constituency groups," and that "the role of management is to mediate among the various constituencies and objectives, perhaps placing more weight on one than the other, perhaps not, but in any event giving weight to all."[119]

[116] Walmart Inc. Corporate Governance Guidelines, WALMART INC. 3 (Feb. 6, 2020), https://pcg.law.harvard.edu/data/BRTPurposeArchive/Walmart1.pdf [https://perma.cc/NXM6-NSZ2]**;** *see also* Bebchuk, *supra* note 108, at 738-39.

[117] Supporters of this pluralistic approach are Stout, Blair, Elhauge, Deakin, Freeman, Hansen and Mayer. *See* Stout, *supra* note 83; Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247 (1999); Elhauge, *supra* note 90; Simon Deakin, *The Corporation as Commons: Rethinking Property Rights, Governance and Sustainability in the Business Enterprise*, 37 QUEEN'S L.J. 339 (2012); Edward Freeman, Strategic Management: A Stakeholder Approach 53 (1984); Erik G. Hansen & Stefan Schaltegger*, The Sustainability Balanced Scorecard: A Systematic Review of Architectures*, 133 J. BUS. ETHICS 193, 195–197 (2016); Colin Mayer, Prosperity 39 (2018).

[118] Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247 (1999). The authors advocate that directors should be viewed as "mediating hierarchs whose job is to balance team members' competing interests in a fashion that keeps everyone happy enough" (at 281) and that "within the corporation, control over the assets is exercised by an internal hierarchy whose job is to coordinate the activities of the team members, allocate the resulting production, and mediate disputes among team members over that allocation" (at 251).

[119] Prof. Eisenberg explains that corporations could be viewed under the lenses of a political model or an economic model. In the political model, he takes a pluralistic approach of the several constituencies and argue that the role of management is to meditate among the various constituencies, giving weight to all. *See* Melvin Aron Eisenberg, *Corporate Legitimacy, Conduct, and Governance–Two Models of the Corporation*, 17 CREIGHTON L.REV 1, 3–4 (1983-1984).

However, if corporations are viewed as economic institutions for the organization of capital towards economic activity and growth, control of the factors of production and return of results should be placed in the hands of privately appointed corporate managers, who are accountable for their performance and who act in the interest and subject to the ultimate control of those who own the corporation. This would result in a more efficient utilization of economic resources. Under this "economic model," unlike the political model, corporations would have a single objective: conducting business activities with a view to corporate profit and shareholder gain.[120] The only exceptions would be those discussed below under the ALI Principles of Corporate Governance (i.e., an obligation to act within the boundaries set by law, according to ethical principles generally recognized as relevant to the conduct of business, and satisfaction of public welfare, humanitarian, educational and philanthropic purposes within reasonable limits).

The main problem with the pluralistic approach of stakeholderism is its lack of clarity and legal guidance.

First, there's much debate even as to who the stakeholders of a corporation would be. The thirty-two states that have constituency statutes in the United States list different interest groups, without much consistency and using excessively wide and vague terms: employees (thirty-one states), customers (thirty-one states), suppliers (twenty-eight states), creditors (twenty-two states), local communities (twenty-two states), society (thirteen states), economy of the state or the nation (twelve states), environment (two states), other (two states) and a catch-all phrase at the end that would encompass virtually anything (fourteen states).[121] Second, in geographical terms, should these constituencies be considered only in the community or location of a company, or generally?[122]

Also, even if the interests of the different constituencies can be reconciled in a win-win situation, there will be cases that trade-offs will be required for the benefit of one group to the detriment of another. While the 2019 Business Roundtable's Statement on the Purpose of Corporation refuses to admit such a conflict,[123] this is simply a factual reality. Trade-offs

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[120] Eisenberg, *supra* note 119, at 5.

[121] For a mapping of these state constituencies statutes, *see* Bebchuk & Tallarita, *supra* note 103, at 91-178.

[122] For example, if a company is considering relocating a plant from location A to location B, creating unemployment in location A but generating jobs in location B, would the negative effects to stakeholders in community A be offset against the positive effects to stakeholders in community B? If the decision is to relocate a plant from the United States to a developing country where labor costs are lower, would the benefits to employees of the developing country offset the jobs lost in America?

[123] "While we acknowledge that different stakeholders may have competing interests in the short term, it is important to recognize that the interests of all stakeholders are inseparable

are inevitable. The pluralistic approach requires that the interests of these different constituencies are weighed and balanced by corporate leaders, but does not offer guidance or parameters, opening room for arbitrary or capricious decisions since directors will be accorded broad discretion with no judicial review. As presented by Karpoff, "finding such agreement among multiple stakeholder groups remains both theoretically and practically elusive."[124]

3. The Constituencies Statutes

With the increase of merger activity in the 1980s, there has been a wave of laws passed in several states amending corporation statutes with a view to protecting nonshareholder constituencies. Usually, they are adopted as amendments to the statutory statement of the director's duty of due care, and, with these changes, they explicitly permit directors to consider the effects of their decisions on a variety of nonshareholder interests, such as employees, customers, suppliers, and local communities. By the letter of the statutes, these provisions would apply both in structural decisions of the board (i.e., relating to changes in the ownership structure, including through sales, takeovers, and changes of control) and operational decisions (i.e., all the other decisions of the board in the operation of a business on a continuing basis).

A majority of the states in America (twenty-five as of 1992, according to Bainbridge,[125] thirty-two as of 2019, according to Bebchuk and Tallarita[126]) now have some version of nonshareholder language. Different legislatures have articulated the rationale for constituencies statutes in different ways. The basic model followed by most of the statutes provides that in discharging their duty of care, directors *may* consider the effects of a decision on not only shareholders, but also on a list of other constituency groups, and this list typically includes employees, suppliers, customers, creditors, local communities, society, economy of the state or the nation and the environment, as well as catch-all language capturing any other unidentified group.

Most of these statutes are permissive (i.e., the directors "may" but are not required to take nonshareholder interests into account) and do not create

in the long term." Statement on the Purpose of Corporation, BUSINESS ROUNDTABLE (Aug. 19, 2019), https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans [https://perma.cc/4Q9X-ZKWA].

[124] Jonathan M. Karpoff, *On a Stakeholder Model of Corporate Governance* (Eur. Corp. Governance Inst., Working Paper No. 749, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3642906 [https://perma.cc/Q3UT-BKU5].

[125] Stephen M. Bainbridge, *Interpreting Nonshareholder Constituency Statutes*, 19 PEPP. L. REV. 971, 985 (1992), https://digitalcommons.pepperdine.edu/cgi/viewcontent.cgi?article=1642&context=plr [https://perma.cc/UC4B-DB9P].

[126] Bebchuk & Tallarita, *supra* note 103, at 91-178.

a new fiduciary duty running from directors to nonshareholder constituencies, which would not have standing to seek judicial review nor damages from a decision. They actually seem designed to protect directors against claims of breach of duty if they choose to take into account interests other than those of shareholders.[127]

No statute sets forth a weight formula for the different interests of constituencies, so that the board has full discretion to identify and weigh the different constituencies as they deem appropriate. The board is not required by the statutes to give dominant or controlling effect to any particular constituent group or interest.[128] Some of the statutes use formulations providing that the nonshareholder interests may be considered '*in addition to shareholder interests*' or somehow linking with the '*best interests of the corporation and its shareholders*.' These formulations make sense, and should be read into the statutes even if not expressly provided, because, according to Bainbridge, if directors would be able to ignore shareholder interests, the directors' fiduciary duties would become meaningless and management would not be held accountable to anyone (since the statutes do not create a fiduciary duty to nonshareholders since the duty is to the corporation alone, and nonshareholders do not have a right of action against the corporation).[129] Perhaps the proper reading of these statutes is that directors are permitted (not required) to make a decision that is "the second best" to shareholders when there is a conflict with a nonshareholder constituency.

As we have seen before, with respect to operational decisions, under current law the business judgment rule will protect virtually all management's decision made informedly, disinterestedly and in good faith, or that is not irrational or tainted by fraud, illegality, or self-dealing.[130] Even in cases of corporate philanthropy, as we will see below, the law evolved to treat corporate donations as proper so long as it involves reasonable amounts and is likely to provide benefits to the corporation. In applying the business

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[127] The Georgia statute permits a Georgia corporation to include in its articles a provision allowing the board to consider other constituencies but provides that "any such provision shall be deemed solely to grant discretionary authority to the directors and shall not be deemed to provide to any constituency any right to be considered." Ga. Code Ann. § 14-2-202(b)(5) (Harrison Supp. 1989). Similarly, the Companies Act in the UK (available at https://perma.cc/3ZLU-3XA4) provides that "the duty imposed by this section on the directors is owed by them to the company (and the company alone)," clarifying that the stakeholders do not have a direct right of action. The Companies Act 1985, c. 6 § 309 (UK).

[128] *See, e.g.*, N.Y. BUS. CORP. LAW § 717(b) (McKinney Supp. 1990) ("Nothing in this paragraph shall create any duties owed by any director to any person or entity to consider or afford any particular weight to any of the foregoing or abrogate any duty of the directors, either statutory or recognized by common law or court decisions.").

[129] Bainbridge, *supra* note 125; Westaway & Sampselle, *supra* note 80.

[130] *See, e.g.*, Joy v. North, 692 F.2d 880 (2d Cir. 1982), *cert. denied*, 460 U.S. 1051 (1983); Kamin v. Am. Express Co., 383 N.Y.S.2d 807 (Sup. Ct.), *aff'd*, 387 N.Y.S.2d 993 (App. Div. 1976).

judgment rule, the courts presumed that an altruistic decision was in the corporation's best interests.[131] Charitable giving produces goodwill and favorable publicity, and ultimately results in more business and higher profits, and therefore should be allowed, within reasonable parameters, sufficient business nexus and no conflicts of interest (as we will see below).

From a historical standpoint, these statutes' changes were apparently targeting structural decisions with the goal of making takeovers harder. They were directed at repealing *Revlon* (i.e. the duty to maximize shareholder monetary gain with a higher price when the company is at sale at an auction contest and the Revlon situation is triggered). Because incumbent target managers are the one group unarguably harmed by hostile takeovers, they are the most direct beneficiaries of the nonshareholder statutes in the context of structural decisions, and "there is a very real possibility that unscrupulous directors will use nonshareholder interests to cloak their own self-interested behavior."[132]

By the enactment of the constituencies statutes, the ABA Committee on Corporate Law voiced a concern for potential confusion and concluded that these statutes could

> radically alter some of the basic premises upon which corporation law has been constructed in this country without sufficient attention having been given to all of the economic, social, and legal ramifications of such a change in the law[133] . . . "permitting—much less requiring—directors to consider these interests without relating such consideration in an appropriate fashion to shareholder welfare (as the Delaware courts have done) would conflict with directors' responsibility to shareholders and could undermine the effectiveness of the system that has made the corporation an efficient device for the creation of jobs and wealth."[134]

In fact, a reading of these nonshareholder statutes as creating a legal duty to other constituencies without according primacy to shareholder interests would be profoundly troubling. A new class or classes of plaintiffs would have access to the courts, fueling a disruptive litigation industry. If directors would be *required* to orient their decisions pursuant to stakeholders' interests, the business judgment rule would be weakened and courts would be called in to weigh the constituencies' interests, which would reduce efficiency and predictability of the legal system. As stated in *Kamin v. American Express Co.*,[135] "the directors' room rather than the courtroom is

[131] *See, e.g.*, Corning Glass Works v. Lucas, 37 F.2d 798 (D.C. Cir. 1929), *cert. denied*, 281 U.S. 742 (1930); Virgil v. Virgil Prac. Clavier Co., 68 N.Y.S. 335, 337 (Sup. Ct. 1900); Steinway v. Steinway & Sons, 40 N.Y.S. 718, 722 (Sup. Ct. 1896).

[132] Bainbridge, *supra* note 125, at 1013.

[133] Other Constituency Statutes, *supra* note 104, at 2253.

[134] *Id.* at 2268.

[135] 383 N.Y.S.2d at 812–13.

the appropriate forum for thrashing out purely business questions which will have an impact on profits, market prices, competitive situations, or tax advantages."

This poses a question: shouldn't there be some type of judicial review of board decisions openly tailored to favor nonshareholder constituencies (especially in a structural decision)? The business judgment rule precludes judicial review of most board decisions and courts are not business experts, but shouldn't the legal system afford some protection in situations of conflicts of interests?

One could argue that conflicts of interests should exist not only when there is a financial interest of the director (the current law), but also when there is an indirect or intangible interest, for example, when a director favors a certain constituency group with whom she has a personal alignment or sympathy, when she uses corporate funds to advance an agenda or cause important to her (both on the liberal and on the conservative realms),[136] when she offers corporate support and funding to a party of her political affiliation, or when she makes a corporate donation to a museum or school that will name an exhibition or building after her. These situations bring prestige and reputational benefit, but typically do not trigger a conflict-of-interest situation under existing law, except in very extreme situations.

In fact, a valid concern to be addressed by the legal system is that managers may improperly invoke ESG factors to enact their own policy preferences at the expense of shareholders—an agency problem for which there is empirical evidence.[137]

In these situations of indirect (or "soft") conflicts of interests, there should be additional precautions to protect against wrongful use of corporate resources. Without necessarily triggering judicial review under the entire fairness rule, courts should be permitted to review the facts and circumstances, make a proportionality assessment, and require compliance with procedural prophylactic steps. For example, management should be

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[136] Examples of topics of a liberal agenda include when corporations use their power and influence to encourage government policymakers to, among other things, repeal laws that they view as harmful to the LGBT community (such as the "bathroom bills"), support laws protecting the right to have an abortion, restrict the types of and circumstances under which guns can be purchased and carried, reform policing and voting procedures they consider harmful to black people, and oppose illegal immigrant controls. Examples of topics of a conservative agenda include when companies, like Hobby Lobby, impose their religious beliefs on their employees and deny them access to federally guaranteed reproductive health services or restrict same-sex health couple's insurance coverage. These examples are cited in Leo E. Strine, Jr., *Good Corporate Citizenship We Can All Get Behind?: Toward a Principled, Non-Ideological Approach to Making Money the Right Way*, 78 BUS. LAW. 329, 346-50 (2023), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4296287 [https://perma.cc/TH7D-ZFLX].

[137] *See* Ronald W. Masulis & Syed Walid Reza, *Agency Problems of Corporate Philanthropy*, 28 REV. FIN. STUD. 592, 630-31 (2015) (finding that corporate philanthropy is often tied to CEO-affiliated charities and reduces firm value).

prepared to show to the courts that they gathered sufficient and appropriate information, conducted a cost-benefit analysis of their decision, examined the negotiations, considered alternative scenarios, engaged in open discussions during deliberations, and obtained disinterested directors' or shareholders' approval.

In *Bayer v. Beran*, for example, where Celanese Corporation of America funded an expensive radio advertising program, plaintiffs claimed that the program was structured to benefit one of the singers, the wife of Celanese's CEO, to "foster and subsidize her career," and to "furnish a vehicle for her talents." [138] While the court did not find an inherent conflict of interest and ultimately applied the business judgement rule to uphold the sponsorship as valid, it did so after considering the facts and circumstances of the case and applying its own checks and balances. The court noted that the plaintiffs failed to provide evidence challenging the singer's competence as an artist, that the cost was disproportionate to the benefits to the corporation, that her compensation was not in conformity with that paid to other similar artists for comparable work, and that she would have received greater prominence in the show compared to other artists. Ultimately, the court even noted that the program's increased popularity resulted in recognition from the public to Celanese, and the program had been discussed and approved by the directors, not only the CEO. In other words, although the court did not apply the entire fairness standard for conflict-of-interest situations, the court did review the facts and circumstances to reach its decision.

I admit that courts are not well-suited to second guess the merits of a business decision, and such a rule would bring unnecessary uncertainty and increase transaction costs, but at the same time courts could be called to review the appropriateness of the decision-making process in such sensitive situations. The courts should not be allowed to evaluate the merits of a business or strategic decision, but only apply procedural safeguards to foster transparency and avoid conflicts of interest. This has been the approach taken by the court in *eBay Domestic Holdings, Inc. v. Newmark*,[139] discussed above, involving a structural decision.

D. In Defense of Stakeholderism

1. The Risk Mitigation Argument

Many scholars correctly argue that stakeholderism will generally create shareholder value because it protects companies against downside risks (including environmental, social, and governance risks), and business decisions motivated solely for opportunities to increase profits would destroy

[138] 49 N.Y.S.2d 2, 7 (N.Y. Sup. Ct. 1944).
[139] 16 A.3d 1, 15-16 (Del. Ch. 2010).

value.[140] Attention to stakeholders' interests would be a means of generating long-term shareholder wealth and improving portfolio- and firm-level risk assessment and mitigation. Sustainable practices would help companies avoid crises because they would provide boards with inputs from the several stakeholders (including employees, authorities, creditors, regulators, and NGOs) that would be valuable for the business. Risk management, by its turn, would contribute to financial performance by reducing the cost of future liabilities due to enforcement actions, legal claims, and other negative risk events, as well as losses to investors when these events become known to the market.

In fact, institutional investors' support for sustainability is not motivated by altruism or the desire to protect stakeholders, but rather because sustainability helps fight systemic risks that are otherwise difficult to diversify in their portfolios. Systemic risks include, among others, the risk of regulatory, socioeconomic, or political changes, climate change, and international commerce and supply-chain disruptions. As a consequence, by failing to establish a sustainability function, directors and managers would be exposing shareholders to increased risk, in particular the so-called "universal owners."

The attractiveness of ESG to companies is because it improves their risk oversight, particularly from a social and ethical standpoint, that is not covered by their legal obligations and compliance systems. In fact, sustainability would be valuable to companies because it complements their compliance systems. Under Delaware law, the board has a duty to ensure that the company has adequate compliance systems and that they respond appropriately to any red flags about ongoing violations.[141] By deterring employees from violating laws, compliance seeks to limit corporate risk-taking. But Delaware's case law directs compliance to targeting *legal* risk, and not *business* risks,[142] and therefore is backwards-looking. In Stavros Gadinis' and Amelia Miazad's words, "where compliance seeks to sanction and deter, ESG seeks to reconcile and inspire,"[143] and "ESG serves shareholders' interests, not because of its upside potential to increase profits, but because it helps companies identify and manage social risks to their business."[144]

This is particularly important to large institutional investors and asset managers that are more sensitive to risks than dispersed shareholders, because, given their large shareholder holdings, they cannot liquidate their positions as readily in the face of systemic risks and certain systemic risks

[140] *See, e.g.*, Stavros Gadinis & Amelia Miazad, *Corporate Law and Social Risk*, 73 VAND. L. REV. 1401 (2020).

[141] *In re* Caremark Int'l, Inc. Derivative Litig., 698 A.2d 959, 970 (Del. Ch. 1996).

[142] *See In re* Citigroup Inc. S'holder Derivative Litig., 964 A.2d 106, 108 (Del. Ch. 2009).

[143] Gadinis & Miazad, *supra* note 140, at 1441.

[144] *Id.* at 1410.

would impact their whole portfolios. For a large portfolio manager, it is difficult to diversify against market-wide risks that involve a broad set of companies, or even an entire industry.

In this sense, some scholars have argued that ESG and sustainability should not only be allowed, but in general should be part of the board's fiduciary duties.[145] Thus, courts should recognize ESG as an essential part of boards' monitoring mission in today's world. Some take the strong view that "developing an ESG function and providing the company with a mechanism for early risk discovery and prevention is an imperative for directors and officers, who should find themselves in bad faith if they fail to act."[146]

Other scholars have alerted that the board's duty under *Caremark* should *not* be extended to a failure to develop and operate adequate reporting and monitoring systems to ensure compliance with ESG-related requirements.[147] Caremark requires a board to proactively ensure that the corporation has established reasonable legal compliance programs, and liability can arise where "(a) the directors utterly failed to implement any reporting or information system or controls; or (b) having implemented such a system or controls, consciously failed to monitor or oversee its operations thus disabling themselves from being informed of risks or problems requiring their attention."[148]

Later, in *In re ProAssurance Corp. Stockholder Derivative Litigation*,[149] the Delaware Court of Chancery clarified that the so-called Caremark "[o]versight claims should be reserved for extreme events" and will not be sustained to hold directors liable for "a commercial decision that went poorly" in retrospect. While noting that "boards are under increasing pressure from constituents to monitor diverse risks," the court acknowledged that the responsibility to oversee such risks "does not eviscerate the core protections

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[145] *See, e.g.*, Martin Lipton, *Understanding the Role of ESG and Stakeholder Governance Within the Framework of Fiduciary Duties, Harvard Law School Forum on Corporate Governance* (Nov. 2022), https://corpgov.law.harvard.edu/2022/11/29/understanding-the-role-of-esg-and-stakeholder-governance-within-the-framework-of-fiduciary-duties/ [https://perma.cc/5BEA-3VJ8]; James C. Woolery & Tim Martin, *ESG and Fiduciaries: A New Age Dawns, Harvard Law School Forum on Corporate Governance* (June 2023), https://corpgov.law.harvard.edu/2023/06/15/esg-and-fiduciaries-a-new-age-dawns/ [https://perma.cc/A2Z9-BRCB].

[146] Gadinis & Miazad, *supra* note 140, at 1466; Leo E. Strine, Jr. et al., *Caremark and ESG, Perfect Together: A Practical Approach to Implementing an Integrated, Efficient, and Effective Caremark and EESG Strategy*, 106 IOWA L. REV. 1885 (2021); E. Norman Veasey & Randy J. Holland, *Caremark at the Quarter-Century Watershed: Modern-Day Compliance Realities Frame Corporate Directors' Duty of Good Faith Oversight, Providing New Dynamics for Respecting Chancellor Allen's 1996 Caremark Landmark*, 76 BUS. LAW. 1, 27 (2021).

[147] Stephen M. Bainbridge, *Don't Compound the Caremark Mistake by Extending It to ESG Oversight*, 77 BUS. LAW. 651, 651 (2022).

[148] *Citigroup*, 964 A.2d at 123.

[149] C.A. No. 2022-0034-LWW, at *1 (Del. Ch. Oct. 2, 2023).

of the business judgment rule."[150] In the court's view, for liability to arise, the directors' oversight failures "must be so egregious that they amount to bad faith. That is, the directors utterly failed to implement a reporting system or consciously disregarded a violation of positive law."[151] In other words, red flags relating to business risks that do not represent violations of law should not trigger Caremark liability.

In any case, the board would be free to reach its own decisions with respect to ESG and sustainability matters and should be protected by the business judgment rule, provided it shows due care in receiving ESG information and properly considering it. In *Caremark*, Chancellor Allen conceded that the design of necessary ESG systems "is a question of business judgment,"[152] protecting board decisions about the design and implementation of such systems under the business judgment rule. Increasing the risk directors could face under Caremark for failure to implement and monitor ESG systems would deter qualified individuals from being willing to serve on boards and would increase the cost of directors & officers insurance.

2. The Efficiency Argument

At the firm-level perspective, there would be efficiency in focusing on nonshareholders' interests because management's failure to understand and respond to ESG risks could hurt the company's long-term financial performance, while monitoring ESG issues can help management identify such risks as well as new opportunities. The ultimate result would be the reduction of the cost of capital,[153] improving brand loyalty, employee retention and motivation, resource allocation and overall competitive advantage.[154]

In efficiency terms, a legal regime that imposes an enforceable duty on managers to profit-maximize would be inefficient since it could, in theory, be enforced by a single shareholder, thus setting corporate governance standards by the lowest moral denominator, i.e. the shareholder who cares least about social and moral values. The shareholder with the least sense of social responsibility would be in command.

Even if allowed by the legal system, profit sacrifice in the name of stakeholder interests should not be unlimited. Management discretion and excessive generosity are subject to reasonability standards, and in fact would

[150] *Id.* at *13–14.

[151] *Id.*

[152] *In re* Caremark Int'l, Inc. Derivative Litig., 698 A.2d 959, 970 (Del. Ch. 1996).

[153] *See* Mark Sharfman & Chitru S. Fernando, *Environmental Risk Management and the Cost of Capital*, 29 STRATEGIC MGMT. J. 569 (2008) (presenting empirical evidence that environmental risk management reduces the cost of equity capital and allows firms to more easily obtain debt financing).

[154] Michael E. Porter & Mark R. Kramer, *Strategy & Society: The Link Between Competitive Advantage and Corporate Social Responsibility*, HARV. BUS. REV. 78, 82 (2006).

be checked and deterred by market competition (a firm that takes on excessively high sacrifices cannot survive), board nomination process (a director who sacrifices too much in profits will not be re-elected) and management compensation arrangements (the stock and stock options held by managers will become less valuable).

3. The Self-regulation Argument

Many have argued that internal corporate policies[155] addressing social and environmental concerns and external pressures, alongside corporate governance mechanisms, are adopted on a voluntary basis and therefore constitute "self-regulation" that is preferable to government regulation in a liberal economy.[156] This type of "soft law" would be more efficient than formal regulation, and more flexible and agile than a legislative process, since companies can communicate more directly with their constituencies and address their concerns through social and market pressure, and yet retain more freedom against state intervention in the business.

E. In Defense of Shareholder Primacy

By now, it should be clear to the reader that stakeholder capitalism can play an important part in fixing today's economy, since government and philanthropy cannot fix the crisis of capitalism on their own. It is also evident by abundant research and data that, in many cases, creating value for shareholders and other stakeholders can be achieved together and that it should not be a zero-sum game. In most cases, Adam Smith's invisible hand will provide that, in pursuing their own interests, shareholders will promote economic development and the interests of society:

> [Each person] generally, indeed, neither intends to promote the public interest, nor knows how much he is promoting it … he intends only his own security; and by directing [his] industry in such a manner as its produce may be of the greatest value, he intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention. Nor is it always the worse for the society that it was not part of it. By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it.[157]

The right balance between shareholder value and stakeholder value

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[155] These include corporate codes of conduct, CSR board committees, business ethics units, supply chain assurances, community representatives and sustainability guidelines, for example.

[156] Lipton et al., *supra* note 84; *see also* Elizabeth Pollman, *Corporate Social Responsibility, ESG, and Compliance*, *in* CAMBRIDGE HANDBOOK OF COMPLIANCE 662, 668 (Benjamin van Rooij & D. Daniel Sokol eds., Cambridge 2021).

[157] ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS 35 (R. H. Campbell Skinner et al. eds., 1976); Karpoff, *supra* note 124, at 477.

would produce net positive results for the corporation itself and all its constituencies, and ultimately economic growth and prosperity coupled with social welfare and justice. However, shareholder value supporters will argue that the change in one of the principal tenets of corporate law (profit maximization and board fiduciary duties towards shareholders) is not the right mechanism, but rather management incentives, market forces and government regulation.

From an economic analysis point of view, Jonathan Macey argues that "fiduciary duties should flow to residual claimants, and to residual claimants alone" and that "the costs of dual fiduciary duties in terms of confusion and misunderstanding by courts and litigants vastly outweigh any potential benefits that the statutes might provide."[158] Shareholders' claims on corporate cash flows are last in line; they get paid only after all other claimants/stakeholders are paid. Managing the firm with a view to generating shareholder benefits is economically efficient because it requires that managers first satisfy all contractual obligations to employees, suppliers and other stakeholders. Instead, managing the firm to maximize other stakeholders' benefits would potentially create an incentive to leave nothing for claimants further down the line, such as shareholders. The expropriation opportunity would be so great that the cost of equity would increase, or simply become unavailable. In other words, by pursuing the interests of those last in line, a firm creates incentives to pay all stakeholders.

As residual claimants, shareholders are the group with the most effective incentives to make discretionary decisions.[159] If we consider the fiduciary duties the main "gap filler" in the context of contracting problems between a principal and an agent, the shareholders (as the residual claimants) are the ones who most need such gap fillers since their "contract" is intrinsically incomplete by nature, and the other constituencies typically have preexisting legal protection from contracts or from the law. Fiduciary duties are a corporate governance device uniquely crafted to fill in the massive gap in this open-ended bargain between shareholders and corporate officers and directors, and shifting fiduciary obligations to nonshareholder constituencies disrupts the judicial gap-filling process out of its proper framework.[160]

For example, employees have protection from their employment agreements, their unions, and labor laws in general. Consumers have contractual relationships, close supervision, and protection by consumer protection agencies and antitrust authorities. Bondholders can draft elaborately detailed contracts to protect themselves, and bond indentures often limit the ability of an issuer to borrow, merge, pay dividends, repurchase stock, issue preferred stock, sell assets, or engage in transactions

[158] Macey, *supra* note 39, at 23–24.

[159] Frank H. Easterbrook & Daniel R. Fischel, *Voting in Corporate Law*, 26 J.L. & ECON. 395, 403 (1983).

[160] *See id.*

with affiliates. In most cases in which a constituency receives more than it is due under its contract with the corporation, the additional value it receives comes at the expense of shareholders, and that would be economically inefficient in terms of value allocation. In other words, shareholders should retain the ultimate authority to control the corporation because they have the greatest stake in the outcome of corporate decision-making, and thus have an intrinsic incentive to make value-enhancing decisions.

As we have seen above, under the pluralistic stakeholder governance model, the board would be entitled to consider the interests of all corporate constituencies and make decisions that benefit constituencies other than shareholders even when doing so does not produce net benefits for shareholders in the long term. This means that the board would be entitled "to transfer wealth on a net basis from shareholders to members of other corporate constituencies."[161] In the long run, if the nonshareholder statutes permit the transfer of wealth from shareholders to other constituencies when their interests are in conflict, the incentives to invest in public corporations will be reduced, negatively impacting capital formation and social wealth generally.

Lucian Bebchuck and Roberto Tallarita concluded that such a nonshareholder view of corporate law would be "an inadequate and substantially counterproductive approach to addressing stakeholder concerns."[162] Because corporate leaders lack actual, real-life, incentives to protect stakeholders' interests, stakeholderism would be illusory in that it should not be expected to produce material benefits to stakeholders. Instead, it would make corporate leaders less accountable and more insulated from shareholder oversight. A single goal like profit-maximization is easier to monitor, and diffuse and non-measurable public interest goals could be a subterfuge for allowing management to engage in business decisions that favor their personal interests.[163]

Also, in the illusory expectation that corporate leaders would protect stakeholders on their own, stakeholderism would "impede or delay reforms that could bring real, meaningful protection to stakeholders"[164] and/or impede more promising solutions to social problems, when external legal and regulatory intervention could be more effective to that goal (such as labor- and consumer-protection laws and carbon-reducing taxes). In other words, "the ESG movement [would be] using the guise of stakeholderism to prevent the government from the regulations that would result in the government

[161] Robert T. Miller, *How Would Directors Make Business Decisions Under a Stakeholder Model?*, 77 THE BUS. LAW. 773, 776 (2002).

[162] Bebchuk & Tallarita, *supra* note 103, at 91.

[163] For example, blocking a takeover when managers fear they will lose their jobs or benefits.

[164] Bebchuk & Tallarita, *supra* note 103, at 1.

assuming its proper role of protecting stakeholder interests."[165]

This view has also been voiced by Tariq Fancy, BlackRock's former global chief investment officer for sustainable investing, in a podcast interview with Capitalisn't recorded on August 10, 2023. As a former insider at the largest institutional investor in the world, he stated that stakeholderism and ESG investing are "a dangerous placebo that is slowing the reforms that we need from the government."[166] Hajim Kim's research also shows that mandating corporate social responsibility can backfire: if stakeholders believe that corporations are legally required to do good, they might reward corporate good behavior less. [167] When the India's Companies Act of 2013 introduced an obligation that firms should spend a minimum of 2% of their profit on corporate social responsibility, many companies that previously exceeded the 2% requirement immediately reduced their CSR expenditures.[168]

Critics of stakeholder capitalism also argue that recent pro-stakeholder statements by corporate leaders, such as the 2019 Business Roundtable Statement on the Purpose of Corporation,[169] are mostly for show and did not bring about significant changes to the signatories' operations and strategies. They offer evidence that these statements tend to be aspirational and ambiguous, that they yield rhetorical and political gain to corporate leaders without producing material benefits for stakeholders.[170]

One of the "perils of stakeholderism," as highlighted by Lucian Bebchuck and Roberto Tallarita, is the insulation of corporate leaders, making them less accountable to shareholders, and in effect to any constituency. The traditional view that managers owe fiduciary duties to shareholders makes them directly accountable to such a constituency, under reasonably clear metrics as enterprise value, earnings, profits, EBITDA, stock prices, and the like. A single objective goal like profit maximization is more easily monitored than multiple, vaguely defined goals trying to accommodate all affected interests.[171] When we shift the fiduciary duty to all stakeholders without defining clear metrics and interest groups, managers'

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[165] John C. Friess, *ESGs Democratic Deficit: Why Corporate Governance Cannot Protect Stakeholders,* 17 VA. L. BUS. REV. 245, 251 (2023) (quoting Bebchuk & Tallarita, *supra* note 103, at 168-73).

[166] *Capitalisn't: An Insider Look at ESG Revisited* (Aug. 10, 2023), https://www.everand.com/listen/podcast/664179982 [https://perma.cc/4A46-E4CE].

[167] Hajin Kim, *Can Mandating Corporate Social Responsibility Backfire?*, 18 J. EMPIRICAL LEGAL STUD. 189, 210 (2021).

[168] *Id.* at 27.

[169] "[W]e share a fundamental commitment to all of our stakeholders. We commit to. . . deliver value to all of them, for the future success of our companies, our communities and our country." *Statement on the Purpose of a Corporation*, BUSINESS ROUNDTABLE (Aug. 19, 2019), https://s3.amazonaws.com/brt.org/BRT-StatementonthePurposeofaCorporation October2020.pdf [https://perma.cc/36Q5-URF5].

[170] Bebchuk & Tallarita, *supra* note 103, at 18, 31 and 76.

[171] Robert Clark, CORPORATE LAW 20 (1986).

decisions become more discretionary and we end up increasing agency costs since managers become less accountable to the extent that they can easily justify any and all of their decisions pointing to any of their many masters. After all, "virtually any management decision, no matter how arbitrary, can be rationalized on the grounds that it benefits some constituency of the corporation."[172] Directors will be able to justify any decision whatsoever and thus will evade all accountability.[173] Many masters means no master.

Elizabeth Pollman warns that "the combination of E, S, and G into one term has provided a highly flexible moniker that can vary widely by context, evolve over time, and collectively appeal to a broad range of investors and stakeholders," leading to "confusion, unrealistic expectations, and greenwashing that could inhibit corporate accountability or crowd out other solutions to pressing environmental and social issues."[174] And the problem with nonshareholder constituency statutes is not only that they require managers and directors to serve too many masters; the problem is that they have the potential to permit managers and directors to serve no one but themselves.[175] It invites managers to pursue private benefits at the expense of value creation.[176] ESG brings the risk of "giv[ing] corporate boards and executives leeway to pursue their own ideological agendas or increase agency costs."[177] The nonshareholder statutes and case law do not establish clear standards by which to make business decisions. In fact, they don't even clarify which interests of the various constituencies are legitimate interests and how they should be balanced against each other. In the absence of normative criteria of any kind, no one can intelligibly say that one business decision is any better—or any worse—than any other.[178] Under the stakeholder theory, every possible decision is as good and as bad as every other possible decision. One should be concerned that the stakeholderism approach could allow managers to advance their own agenda dressed up in stakeholder clothing, which could potentially hurt not only shareholders, but often stakeholders themselves. At best, if not tainted by personal interests from management, business decisions made under the stakeholder model can be the product not of rational deliberation, but rather the outcome of political and other nonrational forces operating on directors as individuals. An "empty vessel" that can be steered any way, as Robert Miller puts it.[179]

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[172] Macey, *supra* note 39, at 32.

[173] Miller, *supra* note 161, at 781.

[174] Pollman, Elizabeth, *The Making and Meaning of ESG* (U. of Penn., Inst for Law & Econ Research, Paper No. 22-23, Oct. 2022), https://ssrn.com/abstract=4219857 [https://perma.cc/39BD-WSQS].

[175] Macey, *supra* note 39, at 32.

[176] Karpoff, *supra* note 124.

[177] Pollman *supra* note 174, at 5.

[178] Robert T. Miller, *How Would Directors Make Business Decisions Under a Stakeholder Model?*, 77 THE BUS. LAW., 773 (Feb. 6, 2022).

[179] *Id.* at 798.

The second peril of stakeholderism is that it delays or prevents legislative and regulatory reforms that could be more effective in protecting stakeholders' interests. For example, protection of employees' interests could be more appropriately achieved by strengthening regulations dealing with minimum wages, union protection, social security benefits, etc. Consumer protection would arguably be better served by antitrust policy and enforcement, and stricter product liability and data protection laws. Instead of voluntary, non-enforceable commitments to greenhouse gas emission reductions, environmental protection could be achieved through carbon taxes, government incentives to renewable energy and green technology, and stricter regulatory constraints on polluting activities.

Zohar Goshen and Assaf Hamdani have warned about the misplaced optimism in thinking that large institutional investors would use their power to steer firms towards environmental, social, and governance objectives (such as lowering carbon emissions), because they lack the right incentives and competence. They argued that such objectives would be more effectively achieved by government regulation and that investor stewardship is a poor substitute for that task. Instead, institutional investors should be using their influence and economic power in a coordinated way to direct politicians to pass effective ESG legislation.[180]

Another critique in allowing corporations to set the agenda in the protection of stakeholders, public interest, and society as a whole is that it lacks democratic justification. In a democratic nation under the rule of law, the elected public representatives are tasked with the important mission to pass laws and review cases reflecting the society's interest. Notwithstanding, the ESG movement would enable corporate managers to assume the traditional role of a democratically elected government to establish the appropriate rules governing the relationship between a corporation and its many stakeholders. When one allows large economic conglomerates to set the agenda in the pursuit of public interest, one would be tainting the democratic process through economic power. As Jonathan Macey puts it, creating such a duty towards non shareholder constituencies "transforms the top managers of public companies from private businessmen into unelected and unaccountable public servants."[181] Democracy would be captured by special interest groups with economic power. When interest groups (liberals or conservatives alike) cannot pass their favored policies through democratic means in parliament, they may instead force their agendas through corporations, large financial institutions and investment firms.

Studies indicate that ownership of stock is concentrated among those with higher incomes. In fact, the wealthiest 10% of Americans own nearly

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[180] Zohar Goshen & Assaf Hamdani, *Will Systematic Stewardship Save the Planet?* (Eur. Corp. Governance Inst., Law Working Paper No. 739/2023), https://ssrn.com/abstract=4605549 [https://perma.cc/C2YX-J9PM].

[181] Macey, *supra* note 39, at 42.

90% of all U.S. stocks.[182] Consequently, "in addition to the fact that at least half of the U.S. population is prohibited from engaging in corporate governance because they do not own shares, even among the shareholders that do own shares, voting power is highly unrepresentative."[183]

Leo Strine, Jr. raises a legitimate concern that corporations are using investors' capital for political and social causes, and explicitly asks the difficult questions: "who are CEOs to use other people's money to advance their own idiosyncratic views of the good? … Are we comfortable with corporate leaders from a privileged sliver of our nation's populace using corporate resources to advance their views on controversial issues on which their company's investors and workforce are divided? Doesn't that risk the many being subjected to too much power by the few—power that comes from managing other people's money?"[184]

While admitting the sensitiveness of this argument, stakeholderism supporters counter by saying that "legal regulation is an important but insufficient means of policing behavior, be it the behavior of individuals, non-corporate businesses, or corporations."[185] That argument may hold true, but the solution would reside in fixing the political process, rather than disturbing corporate law foundations through tampering with corporate governance and fiduciary duty principles. As stated by Adolf Berle, "you cannot abandon emphasis on the view that business corporations exist for the sole purpose of making profits for their stockholders until such time as you are prepared to offer a clear and reasonably enforceable scheme of responsibilities to someone else."[186] Ultimately, the question posed by Tariq Fancy in The Secret Diary of a Sustainable Investor[187] is intriguing: "do you really want your banker redesigning the society for you?"

Further, critics of stakeholderism often argue that sacrificing shareholder value for the benefit of nonshareholder stakeholders would represent a tax on shareholders who do not agree with such an approach. If an investor would be unwilling to give up any profit in exchange for ESG actions, and yet it is forced to do so, this investor would be essentially being taxed by management. By pressing directors for social impact actions, an

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[182] Robert Frank, *The Wealthiest 10% of Americans Own a Record 89% of All U.S. Stocks*, CNBC (Oct. 18, 2021, 4:48 PM), https://www.cnbc.com/2021/10/18/the-wealthiest-10percent of-americans-own-a-record-89percent-of-all-us-stocks.html [https://perma.cc/S78P-6RSU].

[183] Friess, *supra* note 165, at 278.

[184] Leo E. Strine, Jr., *Good Corporate Citizenship We Can All Get Behind?: Toward A Principled, Non-Ideological Approach To Making Money The Right Way*, *supra* note 136 (citing Ralph Nader & Mark Green, Corporate Power in America, 25 STAN. L. REV. 484 (1973)).

[185] Elhauge, *supra* note 39, at 803.

[186] Adolf A. Berle, Jr., *For Whom Corporate Managers Are Trustees: A Note*, 45 HARV. L. REV. 1365, 1367 (1932).

[187] Tariq Fancy, T*he Secret Diary of a 'Sustainable Investor' Part 2*, MEDIUM (Aug. 20, 2021) https://medium.com/@sosofancy/the-secret-diary-of-a-sustainable-investor-part-2-831 a25cb642d [https://perma.cc/3W4T-7J9T].

activist shareholder signals that it is willing to sacrifice some profit, but the costs of these actions will be shared by all shareholders, who would effectively pay a tax on their shares to subsidize the social values of such activist ESG shareholder.[188]

Luigi Zingales and other scholars have also raised concerns that "deviating from profit maximization is a form of taxation, which only the shareholders can impose on themselves. Otherwise, it is expropriation."[189] Absent shareholder approval, a system that sacrifices corporate wealth would mean that costs that are not related to the purpose of the business are being passed on to the residual owners, thus being equivalent to a tax from an economic point of view. Going back to Friedman, it would be "pure and unadulterated socialism" to encourage such corporate managers to spend "other people's money" in pursuit of stakeholder interests that do not align with the profit motive.[190] If the corporation has extra cash for politics or other causes it does not need for business, it should pay out those funds to shareholders and allow them to use these funds in accord with their own beliefs.

II. DUTY OF CARE, THE BUSINESS JUDGMENT RULE AND THE DOCTRINE OF CORPORATE WASTE IN THE ESG ERA

Now, where does that discussion leave us in terms of the board duty of care and the limits of the business judgment rule? I turn to that question next.

Traditionally, corporate law and corporate governance are based on the concept of fiduciary duties, which are creatures of national or state laws and consist basically of the duty of loyalty and the duty of care. The duty of loyalty has several components: the duty to act in good faith, the prohibition on directors standing on both sides of a transaction, and the prohibition on directors deriving any personal benefit through self-dealing.

This is where the business judgment rule comes into play. The business judgment rule is a legal doctrine that protects corporate directors from liability for their business decisions. It also protects a decision of a board of directors from a fairness review unless a well-pleaded complaint provides sufficient evidence that the board has breached its fiduciary duties or that the decision-making process was tainted, such as with a lack of independence or interestedness. The rule encourages freedom of action on the part of directors,[191] and assumes that directors act in good faith, with due care, and

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[188] Jonathan R. Povilonis, *Contracting for ESG: Sustainability-Linked Bonds and a New Investor Paradigm*, 77 THE BUS. LAW. 625-50 (2022).

[189] Luigi Zingales, *Friedman's Principle, 50 Years Later, in Milton Friedman* 50 YEARS LATER 1.

[190] Friedman, *supra* note 43.

[191] As stated in *Pollitz v. Wabash R. Co.*, "questions of policy management, expediency of contracts or action, adequacy of consideration, lawful appropriation of corporate funds to

in the best interests of the corporation. The rule prevents courts from interfering with the internal affairs of corporations, unless there is evidence of fraud, illegality, or self-dealing.

In the landmark case *Aronson v. Lewis*, Delaware courts produced one of the most frequently cited interpretations of the business judgement rule in the United States:

> The business judgement rule is . . . a presumption that in making a business decision, the directors of a corporation acted on an informed basis, in good faith, and in the honest belief that the action taken was in the best interests of the company. Absent an abuse of discretion, that judgement will be respected by the courts. The burden is on the party challenging the decision to establish facts rebutting the presumption.[192]

The other frequently cited business judgement rule case is *Cede & Co. v. Technicolor, Inc.*, where the Delaware Supreme Court stated that a "shareholder plaintiff challenging a board decision has the burden at the outset to rebut the rule's presumption," and "[t]o rebut the rule, a shareholder plaintiff assumes the burden of providing evidence that directors, in reaching their challenged decision, breached any one of the triads of their fiduciary duty−good faith, loyalty or due care."[193] As the Delaware Supreme Court has also decided, a court "will not substitute its own notions of what is or is not sound business judgment . . . if the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company."[194]

Later, in *Grobow v. Perot*,[195] the court has decided that, for satisfaction of the business judgment rule, directors in a business should: (i) act in good faith; (ii) act in the best interests of the corporation; (iii) act on an informed basis; (iv) not be wasteful; and (v) not involve self-interest. The business judgment rule yields to the rule of undivided loyalty of the directors: "[Directors'] dealings with the corporation are subjected to rigorous scrutiny and where any of their contracts or engagements with the corporation are challenged the burden is on the director . . . not only to prove the good faith of the transaction but also to show the inherent fairness from the viewpoint of the corporation."[196]

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advance corporate interests, are left solely to their honest and unselfish decision, for their powers therein are without limitation and free from restraint, and the exercise of them for the common and general interests of the corporation may not be questioned, although the results show that what they did was unwise or inexpedient." 207 N.Y. 113, 124, 100 N.E. 721, 724 (1912).

[192] 473 A.2d 805, 812 (Del. 1984).

[193] 634 A.2d 345, 361 (Del. 1993).

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

[195] Grobow v. Perot, 539 A.2d 180, 183-92 (Del. 1988).

[196] Pepper v. Litton, 308 U.S. 295, 306 (1939).

In re Walt Disney Co. Derivative Litigation,[197] the Delaware Supreme Court stated that lack of good faith may be evident where a director "intentionally acts with a purpose other than that of advancing the best interests of the corporation", and in *Rexene Corp. S'holders Litig*., the court stated that "bad faith will be inferred where the decision is so beyond the bounds of reasonable judgment that it seems essentially inexplicable on any [other] ground."[198] Bad faith has also been defined as irrationality, when a board's decision is so *egregious* or *irrational* that it could not have been based on a valid assessment of the corporation's best interests.[199] Case law is clear that liability for violating a duty to act in good faith attaches only in extreme situations.

As stated above, directors may not breach any positive law the corporation has to uphold, even if they believe that this action would maximize shareholder value because directors consciously deciding to break the law cannot rely on the business judgment rule to protect them. In this context, the expanding body of ESG norms,[200] even if these norms do not have the same enforceability strength of positive law, has the effect of creating a more demanding duty of loyalty, potentially weakening the business judgment rule. Whenever a corporation adopts ESG norms and standards through contract or by self-commitment (what is known as "soft law"), it provides courts with a basis for the construction of enforceable duties, or at least benchmarks for the type of diligence and care expected of management. For example, in the Shell litigation, the Dutch court *inter alia* relied on Shell's own commitment to international standards in order to construe the tort duty of care. [201]

Now, could it be argued that a knowing, deliberate and explicit prioritization of non-shareholder interests at the expense of shareholder interests constitutes a deliberate indifference, and consequently be regarded as bad faith? The Delaware Court of Chancery has held that "[w]hen director decisions are reviewed under the business judgment rule, [the court] will not question rational judgments about how promoting non-stockholder interests—be it through making a charitable contribution, paying employees higher salaries and benefits, or more general norms like promoting a particular corporate culture—ultimately promote stockholder value."[202] As Brumer and Strine have summarized: "the business judgment rule provides a

[197] 907 A.2d 27, 67 (Del. Ch. 2006) (en banc).

[198] In re Rexene Corp. S'holders Litig., 1991 WL 77529, at *11 (Del. Ch.1991) (alteration in original) (quoting In re J.P. Stevens & Co. S'holders Litig., 542 A.2d 770, 780 (Del. Ch. 1988)).

[199] Brehm v. Eisner, 746 A.2d 244, 264 (Del. 2000) (en banc).

[200] For example, the voluntary commitment with enhanced ESG standards and initiatives, international benchmarks, ESG ratings, etc.

[201] Milieudefensie et al. v. Royal Dutch Shell plc, C/09/571932/HA (The Hague District Court 2021).

[202] eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 33 (Del. Ch. 2010).

'safe harbor' for fiduciaries to have the discretion to go beyond mere law compliance."[203]

The doctrine of corporate waste is also not a sufficient remedy to curb decisions excessively focused on stakeholders' interests. According to our courts, "waste entails [any] exchange of corporate assets for consideration so disproportionately small as to lie beyond the range at which any reasonable person might be willing to trade"[204] and "most often the claim is associated with a transfer of corporate assets that serves no corporate purpose; or for which no consideration at all is received. Such a transfer is in effect a gift[205]

An inevitable conclusion is that directors can connect virtually every business decision to a rationally related benefit to the company, absent waste of corporate proceeds.[206] As a policy concern, however, if we understand that management is free to make business decisions explicitly favoring non-shareholder constituencies, and the only thing required is a minimal rational justification to serve the interests of the corporation, the outcome could be a loss of corporate law's capacity to regulate behavior through the threat of liability for corporate mismanagement.[207]

A. Personal Agenda and Reputation

Henry Manne and Henry Wallich expressed skepticism that "socially responsible" corporate expenditures were truly voluntary, independent acts of altruism and argued they were instead examples of corporate public relations or agency costs in the form of self-interested executives pursuing their own prestige to appear as "corporate statesmen"— both representing an abandonment of the free market in favor of ineffective programs that by his account were unlikely to increase social welfare.[208]

One could argue that conflicts of interest should exist not only where there is a financial interest of the director (the current state of law[209]) but also where there is an indirect or intangible interest, for example, when a director favors a certain constituency group with whom she has a personal alignment or sympathy, or where she uses corporate funds to advance an agenda or

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[203] Jennifer S Fan, *Woke Capital Revisited* 46 SEATTLE U. L. Rev. 421, 457 (2023) (quoting Chris Brummer & Leo E. Strine, Jr., *Duty and Diversity*, 75 VAND. L. REV. 1, 67 (2022)).

[204] *Lewis*, 699 A.2d at 336.

[205] *Id.*

[206] *See, e.g.*, Lisa M. Fairfax, *Making the Corporation Safe for Shareholder Democracy*, 69 OHIO ST. L.J. 53 (2008); Steven J. Haymore, Note, *Public(ly Oriented) Companies: B Corporations and the Delaware Stakeholder Provision Dilemma*, 64 VAND. L. REV. 1311 (2011).

[207] Thilo Kuntz, *How is ESG Weakening the Business Judgment Rule*, *in* RESEARCH HANDBOOK ON ENVIRONMENTAL, SOCIAL, AND CORPORATE GOVERNANCE (forthcoming 2023).

[208] HENRY G. MANNE & HENRY C. WALLICH, THE MODERN CORPORATION AND SOCIAL RESPONSIBILITY 2 (1987).

[209] *Aronson*, 473 A.2d at 805.

cause of her liking.[210] These situations bring prestige and reputational benefit but typically do not constitute a conflict of interest under existing law.

Further, the pursuit of a CEO's personal agenda may represent a violation of freedom of speech and an imposition on the workforce. For example, a politically active CEO can push her values on her company, which values will then be passed on to its workers, who will feel inhibited from expressing any contrary opinion at the risk of cancellation or termination. If a corporation takes a stand on a controversial issue and promotes that stand within the workforce, it will force employees who disagree to keep quiet or look for another job. The problem is that only high-end workers with mobility and economic choice, the elite segment of the workforce, will be able to look for new jobs in companies that suit their preferred values. With that, the most powerless segments of the workforce could be alienated or, even worse, forced to accept the corporate values deriving from the CEO's determination.

As presented by Leo Strine Jr., "a system that facilitates corporate inculcation of certain political and social values is disadvantageous for workers because it could make them have to shop for red or blue companies, or just endure working hours in an atmosphere that lacks the pluralism and freedom that represents a key part of being an American."[211]

III. CORPORATE DONATIONS

The discussion above regarding corporate decisions applies to corporate donations,[212] where the tension between shareholders and stakeholders is evident because corporate expenditures receive no monetary short-term financial return. Many state statutes, including the shareholder-centric Delaware, give corporations the "power to . . . [m]ake donations for the public welfare or for charitable, scientific or educational purposes, and in time of war or other national emergency in aid thereof."[213]

In the 19th and early 20th centuries, there was contradictory case law on whether business corporations had the power to make charitable contributions or whether such acts were *ultra vires*. The statute clarifies that firms may make donations, but the limits and purpose of such donations are

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[210] For example, initiatives that favor or advance the LGBT community, the right to have an abortion, that restrict the types of and circumstances under which guns can be purchased and carried, that oppose illegal immigrant controls, that imposes religious beliefs on employees, that restrict restricts insurance coverage for same-sex health couples. *See, e.g.*, Leo E. Strine, Jr., *Good Corporate Citizenship We Can All Get Behind?: Toward A Principled, Non-Ideological Approach To Making Money The Right Way*, *supra* note 136 at 351.

[211] *Id.* at 357; *see also* Ralph Nader & Mark Green, *Corporate Power in America: Ralph Nader's Conference on Corporate Accountability*, 25 STAN. L. REV. 484 (1973).

[212] By corporate donations, or corporate philanthropy, we mean direct cash given to not-for-profit entities and projects, foundation grants, stock donations, employee time, product donations and other gifts in kind.

[213] Del. Code Ann. tit. 8, § 122 (2010).

still governed by fiduciary principles.[214] Social or charitable goals still need to be reconciled with the interests of the corporation and shareholders' long-term value.

Well-structured corporate donations will likely generate shareholder value by strengthening the company's reputation and improving consumer perception and employees' morale. Academic research shows a positive correlation between socially responsible initiatives and corporate and shareholder value.[215] Companies with strong social performance also tend to have strong financial performance.[216]

Corporate philanthropy can provide an important competitive advantage when it is well designed and carefully executed by, for example, building relationships with government officials and community leaders, improving economic conditions of the customer base, retaining talented employees motivated by social goals, and supporting research and development initiatives that lead to innovation. Academic research has indicated that "charitable donations are positively related to financial performance and firm value," for example, through higher revenues and customer satisfaction and reduction of labor and regulatory costs, but "political donations do not appear to enhance shareholder value, but rather tend to reflect agency problems, as they are higher for firms with poor internal corporate governance and strong managerial entrenchment."[217]

Oftentimes, however, corporate donations can have the wrong motivations and involve excessive amounts. Executives also make corporate giving decisions based on self-interest. Agency theory suggests that managers will take actions that maximize their own utility, even if these actions are not in the best interests of shareholders. Corporate giving can enable managers and directors to support their own pet charities, which means that they pursue private objectives at the expense of the firm.[218] For example, corporate donations could be justified by management's personal preferences, such as personal recognition as great benefactors and statesmen, advancement of a personal political agenda, attracting media attention, career

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[214] Yosifon, *supra* note 44, at 214.

[215] *See, e.g.*, Noel Capon et al., *Determinants of Financial Performance: A Meta-Analysis*, 36 MGMT SCI. 1143, 1148 (1990); Ronald Roman et al., *The Relationship Between Social and Financial Performance: Repainting a Portrait*, 38 BUS. and SOC'Y 109, 121 (1999); Joshua Margolis & James Walsh, *People and Profits? The Search for a Link between a Company's Social and Financial Performance* (Lawrence Erlbaum Associates, Inc., 2001).

[216] Although this may be true, this positive association does not establish causation. *See* Matteo Tonello, *Making the Business Case for Corporate Philanthropy*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Aug. 20, 2011), https://corpgov.law.harvard.edu/2011/08/20/making-the-business-case-for-corporate-philanthropy/ [https://perma.cc/XJ97-J9L9].

[217] Hao Liang & Luc Renneboog, *Corporate Donations and Shareholder Value* 2 (Eur. Corp. Governance Inst., Working Paper No. 491, 2016).

[218] William O. Brown et al., *Corporate Philanthropic Practices*, 12 J. OF CORP. Fin. 855-77 (2006).

boosts, or even outright family favors in quid-pro-quo transactions.[219] In corporate donations, executives often receive some credit (in the form of awards, honors, and social recognition) that translates into a psychic benefit and elevates their status in elite social circles.[220]

Of course, good faith considerations have not prevented corporations from making charitable donations to universities, local communities, and other non-profits. It has long been accepted that directors and officers do not violate their fiduciary duties by devoting funds to a social cause as long as the company explicitly states that it expects some benefit to flow back to it, however indirectly.[221] For example, a company can donate to a university because it benefits from an educated workforce. However, while such a loose justification may be sufficient for a small payout, it is doubtful whether it would carry the same weight for a large company donation that might involve a significant part of its resources.

Delaware's frequently cited inaugural case addressing charitable donations by corporations is *Theodora v. Henderson*,[222] where shareholders complained, among other things, that the directors of Alexander Dawson, Inc. had violated their fiduciary obligations when they made a corporate gift of $528,000 to a charitable organization that ran a camp for under-privileged boys. In *Theodora*, the Court decided that corporate donations must be reasonable in amount and have a sufficient nexus to the business. Addressing the magnitude test, the court resorted to the provisions of the Internal Revenue Code pertaining to charitable gifts by corporations, which at the time allowed charitable contributions to be deducted as expenses up to 5% of taxable income.[223]

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[219] For example, in 2002, a civil lawsuit filed by the Securities and Exchange Commission alleged that the former CEO of Tyco International Ltd., L. Dennis Kozlowski, donated company money in his own name to Seton Hall University, his alma mater. After a $3 million donation of Tyco's funds, the most prominent academic building on campus was renamed after Kozlowski name. In August 2005, the New York State Supreme Court found him guilty of stealing hundreds of millions of dollars from the manufacturing conglomerate, including through improper donations, and Seton Hall University removed his name from the academic building. *See* Audrey Williams June, *SEC Suit Says Tyco Executive's Gift to Seton Hall U. Illegally Came From Company Funds*, The Chronicle of Higher Education, (Sept.16, 2002), https://www.chronicle.com/article/sec-suit-says-tyco-executives-gift-to-seton-hall-u-illegally-came-from-company-funds/?bc_nonce=v3zj0cvqhopcuq4ttjkchn&cid=reg [https://perma.cc/H85H-H5ZH].

[220] In a survey of 721 companies conducted by McKinsey, 45% respondents said that "personal interests of CEO/board members" was the most important consideration in determining the focus of the corporate philanthropy program. This was the most frequent response, and in 49% of the cases the CEO was directly involved in making specific funding decisions. *See* Sheila Bonini & Stéphanie Chênevert, *The State of Corporate Philanthropy: A McKinsey Global Study*, THE MCKINSEY Q. (Feb. 2008).

[221] *See* A. P. Smith Mfg. Co. v. Barlow, 98 A.2d 581, 591 (N.J. 1953).

[222] Theodora Holding Corp. v. Henderson, 257 A.2d 398, 404 (Del. Ch. 1969).

[223] Currently the IRS allows for deductions of up to 10% of income according to David Yosifon. Yosifon, *supra* note 44.

The other commonly cited case on corporate charitable giving is *Kahn v. Sullivan*; there, when reviewing a $50 million donation for the construction of a museum to house the art collection of Occidental's retiring CEO, the Court noted that the board of directors analyzed the donation's effect on Occidental's financial condition, the potential for goodwill and other benefits to Occidental, and concluded that it would provide benefits to Occidental for at least the thirty-year term of the lease.[224]

Another relevant case is *A.P. Smith Manufacturing Co. v. Barlow*, where the court upheld a corporate charitable donation on the grounds, *inter alia*, that "modern conditions require that corporations acknowledge and discharge social as well as private responsibilities as members of the communities within which they operate."[225]

The Principles of Corporate Governance by the American Law Institute (ALI) suggests that the two principal factors in determining reasonableness are: (1) the customary level of profit-sacrificing behavior or donations by similar corporations and (2) the nexus between the public-spirited activity and the corporation's business.[226]

With respect to the first factor, the materiality test, management should seek shareholder approval when donations are expected to exceed the applicable limits on the deductibility of donations from taxable income set forth by the tax authorities.[227] With respect to the second factor, the nexus test, there should be an absolute requirement that donations are reasonably related to the business of the corporations or the externalities it causes on society, the environment, and the community. Donations without a business nexus would be inefficient and represent taxation to shareholders.

I argue that, in the optics of fiduciary duty, corporate donations should be permitted and encouraged, but management should have the burden of demonstrating the long-term value creation for the corporation and its shareholders by showing a sufficient nexus to the business, the efficiency in donating the resources (as opposed to applying in the business) and ultimately disclosing clearly and transparently all charitable contribution amounts and recipients.

First, management should select charitable initiatives that leverage the company's unique resources to address a social problem affecting the company's competitive context. In other words, there must be a synergy between corporate giving and its strategy and business activities.

Friedman's doctrine states that if the corporation has extra cash for

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[224] Kahn v. Sullivan, 594 A.2d 48, 51 (Del. 1991).

[225] 98 A.2d at 586.

[226] Principles Of Corporate Governance: Analysis and Recommendations §2.01(b)(2)-(3) (Am. Law Inst. 1994).

[227] For example, the IRS imposes limits on deductibility of donations to charitable contributions that can range from 60% to 20% of annual gross income depending on the type of property a person donates and the type of organization the person donates to. *See Publication 526*, IRS (2023), https://www.irs.gov/pub/irs-pdf/p526.pdf.

politics or other causes it does not need for business, it would generally be more efficient to pay out those funds to shareholders and allow shareholders to make their own charitable donations according to their own beliefs.[228] Companies should only invest in social causes if they can generate more value than anyone else, and there are many activities that satisfy a principle of comparative advantage. For example, Coca-Cola has developed expertise in logistics to distribute its drinks all over the world, including the onerous last mile to rural villages. So, Coca-Cola's Project Last Mile leverages this expertise to distribute medicines throughout several African countries. It delivers medicines rather than drinks, as the former must be kept cool—and, as a drinks company, Coca-Cola has a particular comparative advantage in refrigerated transportation.[229]

Next, companies should be able to *demonstrate* that their giving programs increase shareholder value and social welfare by measuring progress by means of objective performance indicators, such as brand awareness, increase in sales, and new niche markets, among others.

IV. POLICY CONSIDERATIONS

It seems that we are in the middle of a battle between shareholder primacy supporters and stakeholder primacy supporters, and neither side is entirely right. Every few decades, political and academic debates over the proper nature and purpose of the corporation erupt. According to most scholars, corporations exist to maximize shareholder wealth. Others maintain that the corporation should exist for the benefit of multiple constituencies.[230] The "enlightened shareholder value" doctrine does not resolve the issue: by being mindful of stakeholder interests, managers may be better equipped to consider the cash flow impacts of their decisions, but as a conceptual framework to guide corporate law, the stakeholder model provides no insights beyond those already captured by the shareholder model of governance, which directs managers to pursue long-term value for the shareholders. We need to develop middle-ground policies that enable capitalism to move forward.

A. Mandating Cost-Benefit Analysis and Disclosure

In discharging their fiduciary duties when making decisions serving the interests of stakeholders, directors should conduct a cost-benefit analysis and disclose, in general terms, the basis for that analysis. Simply saying, in abstract terms, that a decision protecting a non-shareholder constituency would bring long-term value for the shareholders, should not be sufficient.

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[228] Friedman, *supra* note 43, at 32.

[229] *See* Project Last Mile https://www.coca-colacompany.com/social/project-last-mile [https://perma.cc/J534-WCXQ].

[230] George A. Mocsary, *Freedom of Corporate Purpose*, 2016 BYU L. REV. 1319, 1390 (2017).

For example, plans under the Employee Retirement Income Security Act (ERISA) require that plan fiduciaries, who manage the plan's investments, act with the "care, skill, prudence, and diligence" that an individual familiar with such matters would exercise.[231] To be more concrete, the Department of Labor, which oversees ERISA, issued guidance in 2018 recommending that a fiduciary should have a documented cost-benefit analysis before incurring significant costs related to an environmental, social, or corporate governance (ESG) issue.[232] In its release, the Department of Labor stated that "fiduciaries must not too readily treat ESG factors as economically relevant to the particular investment choices" and that ERISA funds should not be used to "incur significant plan expenses to, for example, fund advocacy, press, or mailing campaigns on shareholder resolutions, call special shareholder meetings, or initiate or actively sponsor proxy fights on environmental or social issues."[233] This cost-benefit analysis requirement should be applicable to directors in every for-profit corporation.

Also, in their annual or sustainability reports, companies should disclose the expected value of their decisions with political, social, or environmental motivations to the company and the shareholders, as well as the means and key indicators that management proposes to use to measure long-term return. For example, if a portfolio manager decides to divest from the fossil fuel industry, instead of framing her decision as a way to reduce pollution, she should demonstrate that the decision is sound because of the potential litigation and regulatory risks and, therefore, the divestment would improve the risk-adjusted return in quantifiable ways.

Managers should only pursue projects that they reasonably expect will have a positive impact on the value of the corporation after accounting for opportunity costs and risks. In other words, it is a basic principle of corporate finance that for-profit corporations should only engage in projects with a positive net present value (NPV), starting with the project that has the highest NPV per dollar of investment.[234] This is referred to as the "NPV rule," and catering to stakeholders for its own sake—i.e., not because it generates positive NPV opportunities—would be an unsustainable governance

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[231] 29 U.S.C. § 1104.

[232] In each of its 2018, 2016 and 2015 Bulletins, the U.S. Department of Labor concluded that an ERISA fiduciary ordinarily may not lawfully pursue collateral benefits ESG. In the 2016 Bulletin, for example, the Department of Labor stated that "plan fiduciaries may not increase expenses, sacrifice investment returns, or reduce the security of plan benefits in order to promote collateral goals." In the 2018 Bulletin, it stated that "plan fiduciaries are not permitted to sacrifice investment return or take on additional investment risk as a means of using plan investments to promote collateral social policy goals." *See* U.S. DEP'T OF LAB., FIELD ASSISTANCE BULL. NO. 2018-1 (2018), [https://perma.cc/4YU9-U8H8] (Apr. 23, 2018); Interpretive Bulletin Relating to the Exercise of Shareholder Rights and Written Statements of Investment Policy, Including Proxy Voting Policies or Guidelines, 81 Fed. Reg. 95879, 95882-83 (proposed Dec. 29, 2016) (to be codified at 29 C.F.R. § 2550).

[233] U.S. DEP'T OF LAB., FIELD ASSISTANCE BULL, *supra* note 232.

[234] Stefan J. Padfield, *Crony Stakeholder Capitalism*, 111 KY. L.J. 442, 442-43, (2022-23).

model.[235] Considering stakeholder interests might help managers better implement the NPV rule in the long term and, therefore, better serve shareholder interests and create overall value. However, decisions with an intentional choice of sacrificing NPV in order to advance broader social objectives should not be allowed and should not go unchecked by the legal and governance systems.[236] Much less so in the case of management's decisions prioritizing management's personal political preferences, personal reputation or prestige over NPV.

Scholars like Stefan Padfield have proposed that such types of decisions, where stakeholder-friendly decisions are not supported by clear NPV calculation and justification, should not be presumed to be fully informed and free of material conflicts, thus not being protected by the business judgment rule. According to him, enhanced scrutiny should apply to these situations, not only to situations that are clearly tainted by a conflict of interest (in which case the entire fairness review applies).[237] According to Delaware Vice Chancellor J. Travis Laster, "enhanced scrutiny applies to specific, recurring, and readily identifiable situations involving potential conflicts of interest where the realities of the decision-making context can subtly undermine the decisions of even independent and disinterested directors."[238] To put it differently, those conflicts are not sufficiently strong to trigger entire fairness, but they also do not comfortably permit business judgment deference.

In other words, there should always be a duty to calculate NPV and return on investment in any corporate decisions, particularly in those that favor stakeholders. These types of decisions should be subject to enhanced scrutiny.[239] The failure to calculate NPV, return on investment, or any accepted methodology to measure value would constitute a type of disregard for management's duty of loyalty. In each board meeting, boards should explicitly record their consideration of each statutorily defined stakeholder and provide some substance as to how the stakeholder was considered in relation to the operations of the business.[240]

As Stefan Padfield concludes in his research, "there is reason to believe that corporate decision-makers are allowing their political biases to corrupt

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[235] Jonathan M. Karpoff, *On a Stakeholder Model of Corporate Governance* (Eur. Corp. Gov. Inst. Working Paper No. 749, 2021), https://ssrn.com/abstract=3642906 [https://perma.cc/2D9U-EXGZ].

[236] Currently, the combination of the overreaching business judgment rule and director exculpation provisions effectively limits most fiduciary duty claims to breaches of the duty of loyalty based on self-dealing, considering management conflicts through the lenses of financial gains only.

[237] Padfield, *supra* note 234.

[238] *In re* Trados Inc. S'holder Litig., 73 A.3d 17, 36–37 (Del. Ch. 2013).

[239] Padfield, *supra* note 234.

[240] Kyle Westaway & Dirk Sampselle, *supra* note 80, at 1072.

their decision-making."[241] He proposes that once a plaintiff submits evidence of express disavowal of concern with shareholder wealth or a non-shareholder wealth rationale to justify a business decision that could be objectively described as political, the burden of proof should be shifted to the board to show that the expected value of that decision (in terms of NPV or ROI) exceed the costs involved at the time of the decision.

In *Bandera Master Fund LP v. Boardwalk Pipeline Partners, LP,*[242] the Court acknowledged that, while it would be accepted that a corporation may take steps that do not maximize profits in the short-term (such as giving to charitable contributions or paying higher wages), it could only do so if it could be rationalized as producing greater profits over the long-term, thus increasing the share of value available for the residual claimants. So, the board should be required to demonstrate objectively the shareholder-value rationale of its decision.

The enhanced (or intermediary) scrutiny review of board decisions has been advocated by important scholars in the context of charitable giving,[243] CEO activism outside business decisions,[244] and political contributions,[245] since pretext and arbitrariness are more likely to occur in these circumstances.

In fact, the enhanced scrutiny argument is a powerful one in situations with soft or nuanced conflicts of interest, such as management's personal political preferences, personal reputation, social recognition, or prestige. Promoting trendy ESG goals "may be an effective way for CEOs of profitable companies to leverage shareholders' money and the corporation's public profile to enhance their personal reputation and garner fawning news headlines."[246]

I agree that such decisions should be subject to stronger checks and balances, but I receive that argument with caution.

From a regulatory cost-benefit analysis, board liability and litigation should be used as policy inducement tools only where market forces cannot provide a satisfactory solution by themselves. In most cases, the market will

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[241] Stefan J. Padfield, *Corporate Governance and the Omnipresent Specter of Political Bias: The Duty to Calculate ROI*, 104 MARQ. L. REV. 47, 47 (2020).

[242] Bandera Master Fund LP v. Boardwalk Pipeline Partners, LP, No. 2018-0372-JTL, 2019 WL 4927053 at *14 (Del. Ch. Oct 7, 2019).

[243] Joseph K. Leahy, *Intermediate Scrutiny for Corporate Political Contribution*s, 44 FLA. ST. U. L. REV. 1119, 1131 (2017).

[244] Savannah Wolfe, *Business Playing Politics: Strengthening Shareholders Rights in the Age of CEO Activism*, 23 LEWIS & CLARK L. REV. 1469, 1472 (2020). By CEO activism, he means CEOs and other C-suite executives using their executive platform to talk about political, social, and environmental topics not directly related to the business.

[245] Leahy, *supra* note 243, at 1131.

[246] Sanjai Bhagat & Todd J. Zywicki, *Does the Market Care about Ethical Investment? It Depends*, THE HILL (Sept. 13, 2021), https://thehill.com/opinion/finance/571962-does-the-market-care-about-ethical-investment-itdepends/ [https://perma.cc/D35Y-4FYB].

respond to stakeholder-driven decisions that allegedly destroy shareholder value by stock sales and price declines (exit), through the purchase of control (takeovers), or through proxy fights to replace management or advance shareholder proposals (voice). However, in the case of controlled companies with dominant shareholders or privately held companies with no liquidity, the remedies of exit, takeover and voice may not be available. Companies with an illiquid trading market may not count on an effective remedy since dissenting shareholders may not be able to sell their shares without loss. Also, in companies with dual-class stock, supermajority voting, or staggered boards, the voice remedy may prove futile, and dissatisfied shareholders may never be able to replace management. Finally, companies with poison pills and takeover defense mechanisms may be immune from takeovers, and the market for change of control will not provide a satisfactory answer.

Also, I don't think that courts second-guessing NPV calculations (even with the assistance of experts) would be an efficient way to curb management's wrong motivations and value destruction. Instead, I believe an efficient solution would be to shift from substance to procedure.

First, when a business decision or transaction could reasonably trigger a situation of conflict or indirect personal benefit (such as the examples mentioned above), the board should always seek the safe harbor protections of Section 144 of the Delaware General Corporation Law (DGCL)[247] (or equivalent statutory protection in other jurisdictions) and have the decision approved by a majority of the disinterested directors or shareholders. Under Section 144 of the DGCL, if the transaction is approved by a majority of disinterested directors or by a majority of disinterested shareholders, then the defendant does not have to prove that it was entirely fair to the corporation, and therefore the court would not review the merits of the decision, or fair dealing or fair price.[248]

Second, I would be favorable to a system whereby, first, boards and managers would be able to demonstrate that they have engaged in good faith attempts to identify all constituencies involved, quantify and reconcile the impacts on each constituency, and ultimately explain why they believe that a decision favoring a non-shareholder constituency brings long-term value to the corporation and the shareholders. I also favor a system of enhanced disclosure whereby the market, in possession of clear and verifiable cost-benefit analysis information, would control companies and managers taking excessively stakeholder-friendly decisions at the cost of the trading price of their shares.

To limit managerial mischief, any proposal to promote deviations from shareholder interests should be transparent, rare, and explicitly justified as avoiding substantial harms or yielding substantial benefits to identifiable

[247] DEL.CODE ANN. tit. 8, § 144 (2010).

[248] *See Toedtman v. Turnpoint Medical Devices, Inc.*, C.A. No. N17C-08-210 RRC, 2019 WL 328559, (Del. Super. Ct., Jan 23, 2019).

stakeholder groups with a view to generating long-term value for shareholders.[249]

Investors need informational clarity about the creation (or destruction) of long-term value and how it impacts share prices. Only when there is clear and verifiable information can investors make a proper investment decision and decide whether they want to continue investing in a given company that is allegedly sacrificing shareholder value for the benefit of non-shareholder constituencies.[250] Apple's CEO Tim Cook once cynically said that "shareholders are welcome to sell their shares of stock if they disagree with the company's sociopolitical positions."[251] There are two problems with this argument: first, investors need to receive clear and complete information about the company's sociopolitical positions and the impact on its value; second, if the shareholder bought her shares when the expectation was pure profit-seeking, then the economic loss that results when a corporation embarks on a course of sacrificing profits cannot be avoided by selling one's shares because the expected decline in earnings will have already been priced into the shares.[252]

B. Clarity in Charters and Opt-Out Mechanisms

While respecting shareholder wealth maximization as the default rule of corporate governance, it is always possible for the parties to opt out of such a rule if this is the intended desire for a specific business organization.

First, the corporation form is not mandatory, and different businesses and initiatives could be organized in legal formats that are not shareholder-centric, such as associations, not-for-profits, public benefit corporations (PBCs), and B-corporations.

In fact, PBCs are a recent form of for-profit corporations recognized by most U.S. states that are driven by both mission and profit, with their organizational documents dictating that they must balance the financial interests of the shareholders with the interests of other stakeholders, such as employees, customers and the environment. B-corporations are companies that receive a certification after achieving a minimum score on the "B Impact Assessment," an evaluation of the company's impact on its workers, customers, community, and environment conducted by a governing body called the B Lab. So, if shareholders feel strongly about holding on to their

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[249] Karpoff, *supra* note 235 (origin of the proposal by Jonathan M. Karpoff).

[250] *See* Virginia Harper Ho, *Risk-Related Activism: The Business Case for Monitoring Nonfinancial Risk*, 41 J. CORP. L. 647, 662 (2016) ("Given the strength of the shareholder wealth maximization norm within the U.S. business community, any policy proposal to encourage responsible investment, investor stewardship, or active investor monitoring of ESG risks must also be justified on the basis of shareholder value to succeed.").

[251] Sam Walker, *You're a CEO—Stop Talking Like a Political Activist*, WALL ST. J. (July 27, 2018), https://www.wsj.com/articles/ youre-a-ceostop-talking-like-a-political-activist-1532683844. [https://perma.cc/5MBC-X73C].

[252] Elhauge, *supra* note 39, at 787.

social mission, they should consider forming a PBC or a B-corporation and not force the stakeholder model into a for-profit C-corporation. In fact, since 2020, a Delaware corporation may opt into (and out of) the PBC provisions by a simple charter amendment. All that is required is a recommendation of the board of directors and approval of a majority of the outstanding shares unless the charter requires a larger majority (DGCL §242).[253]

As Chancellor Chandler noted in *eBay*, "the corporate form is not an appropriate vehicle for purely philanthropic ends, at least not when there are other stockholders interested in realizing a return on their investment . . . Thus, I cannot accept as valid a corporate policy that specifically, clearly, and admittedly seeks not to maximize the economic value of a for-profit Delaware corporation for the benefit of its stockholders."[254]

Clarity about the purpose of a given corporation is paramount. However, with the trend of open-ended corporate purposes in the last century, with companies stating in their charters that their purpose is "any and all lawful business or purpose," such clarity has been materially compromised. Even in the form of for-profit corporations, initial incorporators can always change and often do change the default rules in their charter provisions if this is the intent of the shareholders. If a company is being formed with the intent of serving the interests of stakeholders and not necessarily for the benefit of the shareholders only, why not make it clear in its organizational documents?

As Westaway and Sampselle recommend, companies should describe in their bylaws the process by which the board will mediate prospective conflicts between stakeholders.[255] If the board wishes to anchor a specific preference value to particular stakeholders or establish a purpose hierarchy, the bylaws are the best place to articulate these decision-making policies.[256] Alternatively, a corporation's mission statement could provide context about the type of wealth the corporation proposes to create and the constituencies that the corporation intends to benefit in that journey.[257]

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[253] Del. CODE. ANN. tit. 8 § 242 (2010).

[254] J. Travis Laster, *The Effect of Stockholder Approval on Enhanced Scrutiny*, 40 WM. MITCHELL L.REV. 1443, 1448–50 (2014) (quoting *In re* Trados Inc. S'holder Litig. (Trados II), 73 A.3d 17, 43 (Del. Ch. 2013)); *In re* Dollar Thrifty S'holder Litig., 14 A.3d 573, 598.

[255] Westaway & Sampselle, *supra* note 80, at 1072.

[256] *Id*. at 1072.

[257] For example, ice cream maker Ben & Jerry's was the target of a hostile takeover by Unilever in the 1990s. Ben & Jerry's board accepted Unilever's bid because it felt obliged to maximize shareholder wealth. In 2000, Ben & Jerry's charter was amended to include a lengthy mission statement including: (i) "we strive to create economic opportunities for those who have been denied them and to advance new models of economic justice that are sustainable and replicable;" (ii) "we strive to minimize our negative impact on the environment;" (iii) we seek and support nonviolent ways to achieve peace and justice;" and (iv) "we strive to show a deep respect for human beings inside and outside our company and for the communities in which they live." Another example is the Statement of Christian Purpose made public by arts-and-craft store Hobby Lobby, providing that it is committed to

C. Stakeholders' Board Participation

The other potentially effective way to advance stakeholderism without disrupting the purpose of corporations and the basic foundations of management's fiduciary duty would be to change the rules for the election of directors. Currently, directors tend to favor shareholders' interests because shareholders have the power to hire and fire them. If constituency groups had the power to elect a subset of the company's directors, they could have a better representation of their interest groups in board discussions. A voice on the board would have an important impact in fostering an open debate among constituencies. Even in a situation where a director representing a stakeholder constituency does not have the power to pass decisions benefiting his group, the simple fact that she can bring the discussion to the board raises awareness of her fellow board members and promotes a value-creation discussion that is not solely focused on shareholders.

D. Consult with Shareholders and Seek Approval

Even among supporters of shareholder primacy, there's confusion with terminology and concepts. Some scholars argue that the principal function of a corporation is to maximize profits, while others understand goals such as maximizing market value or shareholder welfare. But as noted by Oliver Hart and Luigi Zingales, those terms are not synonymous and can be viewed and weighed differently by different shareholders.[258] In their view, companies and managements should pursue business decisions that are consistent with the preferences of their investors (which could be short-term financial gain, long-term value, or even social and ethical satisfaction), and by pursuing such preferences, would be maximizing shareholder "welfare."[259] For that, shareholders should be allowed to have a say and vote on corporate policies regarding stakeholders' interests. If shareholder welfare varies in different companies and within different groups of investors, then the shareholders should decide on how shareholder welfare should be understood so that management can receive a clear mandate.

For example, private pension funds investing under the ERISA have to follow the ERISA rule that "a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and for the exclusive purpose of providing benefits to participants and their beneficiaries."[260] So, this should be the corporate policy under the view of an ERISA investor. For an asset manager with a portfolio marketed and sold as "sustainable" or "green," however, investors' welfare would be better served

"providing a return on the owners' investment, sharing the Lord's blessings with our employees, and investing in our community." *See* George A. Mocsary, *Freedom of Corporate Purpose*, 1319 BYU L. REV. 1320, 1379 (2016).

[258] Hart & Zingales, *supra* note 22.

[259] *Id.*

[260] 29 U.S.C.S. § 1104.

by companies that make corporate decisions favoring the environment and society. It does not mean that one investor is right and the other is wrong; it only means that investors have different interests.

As noted by Oliver Hart, shareholders don't always want to maximize shareholder value, and companies "should find out what shareholders want and should pursue that goal, and that is not always value maximization."[261] He continues, "[i]f investors have some objectives other than money, there is no reason why a company's board should ignore them and pursue only profit maximization. The fiduciary duty a board has to a company's shareholders is to maximize their welfare, not just the value of their pocketbook."[262]

As a corollary, companies should be very clear when seeking to market themselves to different groups of investors so that they do not end up with different investor groups whose interests cannot be reconciled. In essence, shareholder welfare would be achieved by satisfying the interests and goals of the largest number of shareholders in a given company, including in terms of time (short-term/long-term) and goals (income generation, environmental concerns, diversity and inclusion, etc.).

To that end, shareholder votes and shareholder participation are necessary.[263] The proponents of that suggestion acknowledge that there will always be costs associated with voting since it could be disruptive to the business if the board had to poll its shareholders for any decision, and many frivolous proposals could be put forward by shareholders. But, in a democracy, aren't citizens polled directly through a referendum on very important matters with major social consequences? Why would it be different in a corporation?

To address that concern, shareholder approval should not be necessary for ordinary decisions by management taken within the broader scope of ESG and sustainability policies and strategies approved by shareholders or the board, leaving management with discretion on how to make decisions consistent with those broadly defined goals. Second, the cost of shareholder participation has been significantly reduced in recent times with the advance of technology and social media.[264] Also, to address the cost of frivolous proposals, certain percentage of shares (say, 5% or the existing Rule 14a-8 thresholds) could be required to support a proposal before it is put to a

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[261] Oliver D. Hart, *Shareholders Don't Always Want to Maximize Shareholder Value*, *in* MILTON FRIEDMAN 50 YEARS LATER 51, 51 (2020).

[262] Oliver Hart & Luigi Zingales, *Serving Shareholders Doesn't Mean Putting Profit Above All Else*, *in* MILTON FRIEDMAN 50 YEARS LATER 55, 56 (2020).

[263] Hart & Zingales, *supra* note 22, at 16.

[264] *But see* Eugene Fama, *Market Forces Already Address ESG Issues and the Issues Raised by Stakeholder Capitalism*, *in* MILTON FRIEDMAN 50 YEARS LATER 59, 62 (2020) (arguing that the divergent tastes of stakeholders for different dimensions of welfare mean that a more general max welfare rule is subject to contract costs that typically make it an inefficient decision rule).

shareholder vote.[265] Welcoming stakeholder suggestions and participation in the voting process (within limits and deterring excessive activism) is preferable to engaging in legal battles to exclude shareholder proposals.[266]

This suggestion is consistent with the "principled, non-ideological approach to making money the right way" advocated by Leo Strine, Jr.[267] When dealing with decisions and expressions on political and social issues by corporations, he argues that those that are "intrinsically connected" to the company's business and externalities should be permissible and encouraged, but those that are not intrinsically related should be avoided or at least count on "guardrails like approval by not just the full board, but stockholders, that create greater legitimacy and increase the likelihood that decisions will reflect consideration of all reasonable perspectives and embody a consensus view of their investors."[268] Board and stockholder approval increases the likelihood that resulting decisions will reflect consideration of all reasonable perspectives and embody a consensus view of their investors, and not just decisions personally driven by the CEO.

In other words, his suggestion goes, if a company purports to take positions on external public policy, its positions should result from "a deliberative process of the board of directors based on the direct relevance of the policy question to the company, and not just reflect the personal view of the CEO without board backing."[269] Political spending by corporations should ideally be eliminated, leaving shareholders to use their own money to support a given political party or candidate.[270] Nonetheless, if political spending is to be pursued anyway, corporate funds should only be used in such pursuit if approved by a majority of shareholders and consistent with the company's values.[271]

It must be noted, however, that shareholder participation is not always value accretive. Shareholder meetings can frequently become a battleground between ESG activists and ESG opponents, representing a waste of corporate assets and a sequestration of management's time and energy. When

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[265] Under SEC Rule 14a-8, to be eligible to submit a proposal, a shareholder must satisfy certain minimum investment thresholds ($2,000-$25,000 in market value of a company's securities in the prior 1-3 years) and provide a written statement that the shareholder intends to continue to hold the securities. *See* 17 CFR § 240.14a-8 (2024). These requirements may seem too low to efficiently deter frivolous proposals.

[266] For example, the several requests from issuers to the SEC to exclude activist shareholder proposals from the proxy statements because they would interfere with the conduct of the business, and the recent lawsuit involving ExxonMobil regarding a proposal to make the company gradually transition away from fossil fuel. *See* ExxonMobil Corp. v. Arjuna Cap. LLC et al, No. 4:24-cv-00069, 2024 WL 3075862, at *3, *3 (N.D. Tex. Jun. 17, 2024).

[267] Leo E. Strine, Jr., *supra* note 136 at 329.

[268] *Id.* at 330.

[269] *Id.* at 366 (footnote omitted).

[270] *Id.* at 267.

[271] *Id*. at 367.

commenting on the recent shareholder battle at ExxonMobil, Derek Kreifels, CEO of the State Financial Officers Foundation, stated that "activists have hijacked the shareholder proposal process by buying shares with the express purpose of strong-arming companies like ExxonMobil to adhere to their radical Net Zero agenda; in other words, they are trying to force a company to act against its own interests."[272]

ExxonMobil filed a lawsuit in January against a group of activist investors whose shareholder proposal was aimed at forcing the company to reduce its emissions to address climate change.[273] The proposal would restrict the amount of oil and gas ExxonMobil produces, which could ultimately reduce profitability. Exxon's complaint argues that, unlike shareholders who invest in a company to get a return on that investment, activist shareholder groups become shareholders "solely to campaign for change through shareholder proposals that are calculated to diminish the company's existing business."[274]

In its proxy statement for the 2024 shareholder meeting, ExxonMobil alerted its shareholders that "the shareholder proposal process as it is currently being applied is not serving the best interest of investors," and that "the proposal process is being abused by those who treat shareholder democracy as a venue for activism and counter-activism."[275] ExxonMobil's management has observed "a distinction in approach between [its] investors, who are looking to ensure long-term economic value, and other shareholders, who may have acquired or borrowed a small number of shares to pursue their own agendas," what they call "serial proponents," who bring a flood of proposals repeatedly each year at the cost of $150,000 per proposal.[276] Therefore, in order to make the shareholder participation process effective when addressing ESG topics, it would be necessary to apply certain procedural safeguards, such as minimum shareholder ownership percentages, minimum holding periods, and shareholder liability for abuse of the right to submit proposals.

V. THE SOCIAL FUNCTION OF CORPORATIONS IN BRAZIL

So far, we have examined the purpose of a for-profit corporation and the application of the business judgment rule in the context of the law of the state of Delaware, which is the most important state of incorporation for the largest companies in the United States and worldwide. However, when

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[272] Kevin Killough, *Exxon Shareholder Meeting Will be a Battleground Between Climate Activists and ESG Opponents*, JUST THE NEWS (May 28, 2024), https://justthenews.com/politics-policy/energy/exxon-shareholder-meeting-will-be-battleground-between-climate-activists-and#article [https://perma.cc/U6UX-WW9P].

[273] *See Exxon Mobil*, 2024 WL 3075862, at *1.

[274] Killough, *supra* note 272.

[275] Exxon Mobil Co., Notice of 2024 Annual Meeting and Proxy Statement (Form DEF 14A), 79–80, (Apr. 11, 2024).

[276] *Id.* at 79.

confronted with situations of conflict between shareholders and other stakeholders, different legal systems around the world attribute different weights to each of the constituencies involved.

In some jurisdictions, the purpose of a corporation is focused on the shareholders, and the corporate statutes assign the ultimate decision-making power to them. In such situations, the shareholders are free to weigh the interests of the different stakeholders (including themselves). Other jurisdictions, like Delaware, while acknowledging that the purpose of a corporation is to serve the shareholders' interests, attribute the decision-making power to professional management elected by shareholders, who must act for the benefit of the shareholders and the corporation. In some cases, as discussed above, corporate statutes set forth that the interests of other stakeholders may be taken into consideration by management in their business decisions, permitting (but not affirmatively requiring) that potential situations of conflict between shareholders and other stakeholders may be resolved in favor of non-shareholders. Other jurisdictions create an affirmative duty of management to protect the interests of stakeholders in general, not only shareholders.

The situation of Brazil and other jurisdictions in the Global South is intriguing. Brazil is the 5th largest country in the world, with the 8th largest gross domestic product.[277] The Brazilian legal system is organized following a civil law tradition, similar to Germany, France, and Portugal, where the principal source of law that binds all courts comes from statutes enacted by Congress, and case law is supplementary to interpret and fill gaps from statutory law, but not to create new law. In this context, the protection of stakeholders' interests has been present in Brazilian public policy and statutory law for several decades.

A. Public Policy Stakeholderism Starts to Permeate Corporate Law in Brazil

Mariana Pargendler has stated that, even before the "rise of ESG," Brazil has incorporated public policy and distribution objectives into corporate law to mitigate high inequality and externalities.[278] According to Pargendler, problems of state capacity to curb externalities and address inequalities help explain the rise of "heterodox stakeholderism," which reflects not the current stakeholderism wave of the Global North but the heterodox incorporation of a broader set of public policy and distributional objectives into corporate law to protect non-shareholder constituencies.[279] For example, despite the fundamental importance of limited liability for all

[277] The World Bank Group, Brazil–World Bank Group Data, available at https://data.worldbank.org/country/brazil [https://perma.cc/DRS7-MUJ8].

[278] Mariana Pargendler, *Corporate Law in the Global South: Heterodox Stakeholderism*, 47 SEATTLE UNIV. L. REV. 535, 537 (2024).

[279] *Id.*

corporate forms and economic development, "Brazil has effectively eliminated limited liability for compensation of harm to consumers, workers, and victims of environmental harm, as well as for directors, officers and controlling shareholders of failed financial institutions,"[280] which in Pargendler's view is a sign of stakeholderism through public policy.

The first significant erosion of limited liability dates to Brazil's Labor Law of 1943, which imposed joint and several liability on all entities belonging to an "economic group" for debts to workers.[281] Such encroachment to limited liability would be justified to protect the workers, a vulnerable stakeholder group, to the detriment of the corporation and its shareholders.

Next, in 1964, a statute on financial institutions made controlling shareholders, directors, and officers of financial institutions liable in case of Central Bank intervention due to insolvency or wrongdoing in financial institutions, with the aim of protecting public savings and consumers in general. [282]

The next material advancements of stakeholderism into corporate law came: (i) in 1990, when the Consumer Protection Code mandated judges to pierce the corporate veil of an entity "whenever its personality is, in any way, an obstacle to the compensation of harm caused to consumers,"[283] and (ii) in 1998, when an environmental protection statute authorized piercing the corporate veil of an entity "whenever its personality is an obstacle to the compensation of harm caused to the quality of the environment."[284]

In fact, the attack on limited liability in Brazil seems to be concentrated in the contexts of vulnerable stakeholders and difficult regulation such that scholars have decried the "end of limited liability" in the country.[285] Other examples from the Global South are from India,[286] Colombia,[287] and

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[280] *Id.* at 545.

[281] CONSOLIDAÇÃO DAS LEIS DO TRABALHO [C.L.T.] [Consolidated Labor Laws] art. 2 § 2 (Braz.).

[282] Lei No. 6.024, de 13 de março de 1974, Diário Oficial da União de 13.03.1974, Seção II Arts. 39-41 (Braz.).

[283] Lei No. 8.078, de 11 de setembro de 1990, Diário Oficial da União de 12.09.2008, Seção V Art. 28, §5 (Braz.).

[284] Lei No. 9.605, de 12 de fevereiro de 1998, Diário Oficial da União de 02.13.1998, Art. 4 (Braz.).

[285] *See* BRUNO MEYERHOF SALAMA, O FIM DA RESPONSABILIDADE LIMITADA (2014).

[286] India has mitigated limited liability in corporate groups by recognizing a doctrine of enterprise liability for the benefit of tort victims of hazardous activities. In the context of the Bhopal disaster of 1984, when toxic gas leakage from a Union Carbide pesticide plant took thousands of lives, Indian courts held parent companies liable for tort victims of hazardous activities. *See* Abhi Raghunathan, *The Grand Trunk Road from Salomon to Mehta: Economic Development and Enterprise Liability in India*, 100 GEO. L. J. 571, 571-73 (2012).

[287] In Colombia, shareholders of limited liability companies can be held liable for tax and labor obligations irrespective of fault. In addition, Colombia's bankruptcy law also makes

Argentina.[288]

B. Stakeholderism Reaches the Brazilian Constitution and Brazilian Corporations Law

Since 1988, the Brazilian Federal Constitution has elevated the "social function" of property as a fundamental value to be protected at the constitutional level. Article 5 of the Brazilian constitution states that the right to property (and the protection of property by the government) is a fundamental right of Brazilian citizens (subsection XXII), but at the same time, it states that all property rights shall be exercised to comply with their "social purpose" (subsection XXIII).[289]

Similarly, when dealing with the general principles of economic activity, article 170 of the Brazilian Federal Constitution states that the economic order of the market, founded on the appreciation of the value of human labor and on free enterprise, is intended to ensure everyone a dignified existence, according to the imperative of social justice, with due regard for national sovereignty, private property, social function of property, free competition, consumer protection, environment protection, reduction in regional and social inequalities, pursuit of full employment, preferential treatment for small-sized enterprises.[290]

The constitutional principles of social purpose are then materialized in several Federal, State, and municipal laws and government regulations, as discussed above.

As a corollary of the social function of property, Brazilian corporate law provides for the social function of firms and corporations. The Brazilian

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parent companies presumptively liable for obligations of subsidiaries. *See* Pargendler, *supra* note 278, at 550 (referring to Colombian statutes of 2006 and 1995 (Law No. 1116 of 2006 and Law No. 222 of 1995)).

[288] In the Deltec case of 1973, the Supreme Court of Argentina imposed liability on the Canadian parent company and other foreign affiliates for the debts of a bankrupt Argentine company to protect the Argentine society. *See* PHILLIP I. BLUMBERG, THE MULTINATIONAL CHALLENGE TO CORPORATION LAW 187 (1993).

[289] Constituição Federal [C.F.] art. 5, caput, XXII-XXIII (Braz.) ("All people are equal before the law, without any distinction whatsoever. Brazilians and foreigners residing in the country are ensured the inviolability of their right to life, liberty, equality, security, and property, under the following terms: . . . XXII – the right of property is guaranteed; XXIII – property shall comply with its social purpose . . .").

[290] *Id.* art. 170, I-IX ("The economic order, founded on the appreciation of the value of human labor and on free enterprise, is intended to ensure everyone a dignified existence, according to the imperative of social justice, with due regard for the following principles: I – national sovereignty; II – private property; III – social function of property; IV – free competition; V – consumer protection; VI – environment protection, which may include differentiated treatment in accordance with the environmental impact of goods and services and of their respective production and delivery processes; VII – reduction in regional and social inequalities; VIII – pursuit of full employment; IX – preferential treatment for small-sized enterprises organized under Brazilian law and having their headquarter and management in Brazil.").

Corporations Law, enacted in 1976, has three important provisions addressing the social function of shareholder control, the social function of the fiduciary duty of management, and the social function of corporate donations.

At the shareholder level, article 116 of the Brazilian Corporations Law provides that a controlling shareholder shall use its controlling power in order to make the corporation accomplish its corporate purpose and perform its social function and shall have duties and responsibilities over other shareholders of the corporation, those who work for the corporation, and the community in which it operates.[291] As such, article 116 typically applies in situations of abuse of control, when shareholders are required to vote in a meeting and the controlling shareholder imposes its majority vote, causing harm to minority shareholders or other stakeholders without a legitimate justification.

At the management level, article 154 of the Brazilian Corporations Law provides that directors and officers shall use their powers to achieve the corporation's corporate purpose and to support its best interests, including the interest of the public at large, with due regard to the social function of the corporation.[292] Similarly, article 154 would apply to capricious management decisions that cause harm to the corporation, the shareholders, and other stakeholders.

When regulating corporate donations, article 154, §4 of the Brazilian Corporations Law provides that "directors and officers have the power to authorize reasonable corporate donations and free dispositions in favor of employees or the community where the company is situated, considering its social responsibilities." [293] However, statutory and case laws do not offer guidance regarding the reasonableness of donations or the contours of social responsibilities.

In practice, the "social function" of corporations in Brazil serves as justification for the protection of the interests of minority shareholders and other external constituencies. The social function comes into play when there are internal conflicts of interest (involving the corporation and minority shareholders, or the majority and minority shareholders) or in situations of

[291] Lei No. 6.404, de 15 de Dezembro de 1976, Diário Oficial da União [D.O.U] de 17.12.1976 Seção IV art. 116 (Braz.) ("Art. 116 – Sole Paragraph. A controlling shareholder shall use its controlling power in order to make the corporation accomplish its purpose and perform its social function, and shall have duties and responsibilities towards the other shareholders of the corporation, those who work for the corporation and the community in which it operates, the rights and interests of which the controlling shareholder must loyally respect and heed.").

[292] *Id*. art. 154 ("Art. 154. An officer shall use the powers conferred upon him by law and by the bylaws to achieve the corporation corporate purposes and to support its best interests, including the requirements of the public at large and of the social role of the corporation.").

[293] *Id*. art. 154, §4 ("Art. 154. §4 – In view of the corporation's social responsibilities, the administrative council or the board of directors may authorize the performance of reasonable gratuitous acts to benefit the employees or the community to which the corporation belongs.").

external conflicts (involving the corporation or its shareholders versus non-shareholder stakeholders, for example, employees or the environment).[294]

Most frequently, the social function is used as an equity remedy, as a prohibition of the abusive exercise of a legal right (e.g., the right to vote). According to Brazilian scholars, pursuant to Art. 115 of the Brazilian Corporations Law, shareholders' right to vote in a meeting can be motivated and guided by the personal interest of the shareholder, but it cannot create harm or damage to the corporation, or the other shareholders considered as a whole.[295]

In other words, the social function of the Brazilian Corporations Law on its face does not create an affirmative, actionable obligation, but rather serves to deter harmful actions. The social function also has an interpretative function when there are two valid competing interests or principles at stake, and decision-makers (management, courts, government authorities) have to make a choice. In such cases, the social function is used as the legal basis for a decision, and the business judgment rule will protect decisions taken with a view to protecting stakeholders other than shareholders.

There is disagreement among Brazilian commentators as to whether non-shareholder stakeholders have standing to sue and bring lawsuits against the controlling shareholders and directors under the Brazilian Corporations Law for damages caused to the corporation and its constituencies. Fabio Comparato, Calixto Salomão Filho[296] and Eduardo Secchi Munhoz,[297] for example, are of the opinion that only shareholders are able to bring a lawsuit for damages against controlling shareholders and directors under the aforementioned articles 116 and 154 of the Brazilian Corporations Law. However, Modesto Carvalhosa[298] and Ana Frazão[299] understand that the "social function" of articles 116 and 154 has the effect of creating a private right of action for the benefit of non-shareholder stakeholders, such as "employees, investors, creditors, government authorities and any other person damaged by the corporation." There is no meaningful case law to settle this controversy.

As discussed above, in addition to the Corporations Law, the "social

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[294] For example, the Brazilian Federal Supreme Court has stated that all economic activity must be sustainable and that the pursuit of profit by a corporation cannot endanger the environment S.T.F., ADI-MC 3540 DF, Relator: Min. Celso de Mello, 09.01.2005, Diário da Justiça Eletrônico [D.J.E.] 03.02.2006, 528 (Braz.).

[295] MODESTO CARVALHOSA, COMENTÁRIOS À LEI DAS SOCIEDADES ANÔNIMAS 454 (2d ed. 2003); ANA FRAZÃO, FUNÇÃO SOCIAL DA EMPRESA 289 (2011).

[296] FABIO KONDER COMPARATO & CALIXTO SALOMÃO FILHO, O PODER DE CONTROLE NA SOCIEDADE ANÔNIMA 529 (2005).

[297] EDUARDO MUNHOZ, EMPRESA CONTEMPORÂNEA E DIREITO SOCIETÁRIO, PODER DE CONTROLE E GRUPOS DE SOCIEDADES 41 (n.d.).

[298] Modesto Carvalhosa, *Responsabilidade Civil de Administradores e de Acionistas Controladores Perante a Lei das S/A*, 699 REVISTA DOS TRIBUNAIS, 43 (1994).

[299] Frazão, *supra* note 295, at 406.

function" permeates other laws in Brazil that will have the effect of constraining the pure profit-seeking by firms, such as labor laws[300] (for example, protection of employees, work safety requirements, minimum wages and benefits), bankruptcy laws[301] (for example judicial reorganizations to preserve jobs and taxes), environmental laws[302] (requiring environmental licensing, pollution control, and strict liability for environmental damages) and consumer laws (requiring, for example, discounted admission to students and teachers to shows and cultural events,[303] and free public transportation to disabled people). [304]

In comparison to the law of Delaware, Brazil has some similarities and some differences. First, the Brazilian Corporations Law can be considered a "constituency statute," as described above, to the extent that: (i) control and management of corporations are constrained by, and must respect, the social function of property of the securities set forth in the Brazilian Constitution; and (ii) non-shareholder stakeholders are expressly protected by the statute in the context of the voting rights of controlling shareholders (Art. 116), the discharge of fiduciary duties of management (Art. 154) and corporate donations (Art. 154, §4). Like in Delaware and other U.S. states, absent a situation of personal conflict, the business judgment rule in Brazil will generally protect informed decisions of the board taken in favor of non-shareholder stakeholders, even when they sacrifice profit or other interests of shareholders. Unlike in Delaware, however, the law in Brazil is not yet settled on whether or not non-shareholder constituencies would have a private right

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[300] CONSOLIDAÇÃO DAS LEIS DO TRABALHO [C.L.T.] [Consolidated Labor Laws] (Braz.).

[301] Lei No. 11.101, de 9 de Fevereiro de 2005, art. 47 (Braz.), as amended (The "judicial recovery aims to make it possible to overcome the debtor's economic-financial crisis situation, in order to allow the maintenance of the operations, the employment of workers and the interests of creditors, thus promoting the preservation of company, its social function and stimulation of economic activity.").

[302] Brazilian Forest Code (Lei No. 12.651, de 25 de Maio de 2012, Diário Oficial da União [D.O.U.] de 28.05.2012.); Environmental Crimes Law (Lei No. 6.938, de 31 de Agosto de 1981, Diário Oficial da União [D.O.U] de 02.09.1981); National Environmental Policy (Lei No. 6.938, de 31 de Agosto de 1981, Diário Oficial da União [D.O.U] de 02.09.1981.); Water Use National Policy (Lei No. 9.433, de 8 de Janeiro de 1997, Diário Oficial da União [D.O.U.] de 09.01.1997).

[303] For example, in 2006, the Brazilian Supreme Court was called to decide whether a law that forced museums, stadiums, movie theatres and organizers of shows, expositions and other cultural a sports events to offer admission tickets at half price to students and teachers violated the Brazilian Constitution. Medida Provisória No. 2.208, de 17 de Agosto de 2001 (Braz.), superseded by Lei No. 12.933, de 26 de Dezembro de 2013 (Braz.).The Court decided that, notwithstanding the constitutional right of free enterprise and non-governmental intervention, other rights protected by the Constitution, such as the right to education, culture and sports, would justify such law imposing such price controls. S.T.F., ADI 1950, Relator: Min. Eros Grau, 03.11.2005, 234 Díario da Justiça [D.J.], 02.06.2006 (Braz.).

[304] The Brazilian Supreme Court decided in favor of Law No. 8,899/1994, which mandated companies providing public transportation to offer free transportation to disabled people. STF, ADI 2649, Justice Carmen Lucia, October 17, 2008. S.T.F., ADI 2649, Relator: Min. Carmen Lucia, Tribunal Pleno, 08.05.2008, 207(2) R.T.J.,583,17.10.2008 (Braz.).

of action against the controlling shareholders and directors for violations under the Brazilian Corporations Law.

CONCLUSION

The corporate world is increasingly concerned with protecting stakeholders' interests in business decisions, with companies engaging in corporate social responsibility initiatives and adopting practices that consider environmental, social, and governance factors alongside financial performance. Consequently, the Dodd-Berle debate from the 1930s and Milton Friedman's teachings in the 1970s regarding the purpose of a corporation and the tension between shareholder primacy and stakeholderism are reinvigorated. ESG considerations have become increasingly important in risk mitigation and shareholder value protection, since externalities are becoming more extreme, requiring urgent coordinated action that cannot be handled by government regulation alone, which, if not addressed could create systemic risks impacting all businesses at once. Stakeholder capitalism nonetheless receives criticism for its flaws in capital allocation, unclear measurement and disclosure, lack of accountability, negative impact on financial performance and distraction from the need of government regulation. Certain extreme situations of stakeholder-centric decisions that cannot be reconciled with value creation for shareholders could potentially constitute a breach of management's duty of loyalty if they involve self-dealing or conflict of interest situations, resulting in the unavailability of the business judgment rule protection.

Under the current law, a self-dealing situation arises only when it involves a direct financial interest of the manager, but not in cases of indirect or intangible interest where the manager is motivated by her own prestige and reputational benefit (for example, when a director favors a certain constituency group with whom she has a personal alignment or sympathy, when she uses corporate funds to advance an agenda or cause important to her, when she offers corporate support and funding to a party of her political affiliation, or when she makes a corporate donation to a museum or school that will name an exhibition or building after her). I believe that in these situations of non-financial conflicts of interests, or "soft conflicts," there should be additional precautions to protect against wrongful use of corporate resources because market forces may not provide a satisfactory solution. In most cases, the market will respond to stakeholder-driven decisions that allegedly destroy shareholder value by stock sales and price declines (exit), through purchase of control (takeovers) or through proxy fights to replace management or advance shareholder proposals (voice). However, in the case of controlled companies with dominant shareholders, or privately held companies with low liquidity, the exit, takeover, and voice remedies may not be available.

In such circumstances, directors should always conduct a cost-benefit analysis, explain the value created to shareholders from stakeholder-friendly

decisions and disclose in general terms the basis for such decisions. Whenever possible, boards should seek the approval of disinterested directors or shareholders when decisions could reasonably trigger a conflict of interest or personal benefit situation. Without necessarily triggering judicial review under the entire fairness rule, courts should be permitted to review the facts and circumstances, make a proportionality assessment, and require compliance with procedural prophylactic steps. I would be favorable to a system that requires managers to engage in good faith attempts to identify all constituencies involved, to quantify and reconcile the impacts on each constituency, and to explain why they believe that a decision favoring a non-shareholder constituency ultimately brings long-term value to the corporation and the shareholders.

I would also favor a system of enhanced disclosure whereby the market, in possession of clear and verifiable cost-benefit analysis information, would curb companies and managers taking excessively stakeholder-friendly decisions at the cost of the trading price of their shares. Clarity about the purpose of a given corporation is paramount, and companies should describe in their organizational documents if they intend to serve the interests of stakeholders other than shareholders, and the process by which the board will mediate prospective conflicts between stakeholders and shareholders.

Clear, well-structured, and properly executed stakeholder-friendly decisions will likely create long-term value to shareholders and are germane to the shareholder primacy doctrine, but impulsive, poorly structured decisions taken by managers seeking personal reputation and recognition will often translate into destruction of shareholder value and therefore should be deterred by the law.