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On an Expansive Definition of Shareholder Value in the Boardroom

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October 22, 2019

Directors of a Delaware corporation must act in the best interest of the corporation and its shareholders.[1] Other *stakeholders* – such as employees, creditors, customers, and suppliers – may only be considered by directors to the extent there are rationally related benefits to the welfare of shareholders. The preceding two tenets of Delaware law may on occasion appear to pose challenges to a corporate board considering an environmental or social[2] initiative that cannot readily be supported by traditional metrics of long- term *financial* value for shareholders. However, I submit that boards have the discretion to take an expansive view of shareholder welfare or value that is reflective of non-financial considerations increasingly espoused by institutional and retail shareholders. To the extent shareholders publicly and privately articulate their support for a corporation's environmental and social agenda, directors should be able to confidently take these into account when assessing whether a board-level decision is in the best interest of the corporation and its shareholders, without direct and express linkage to shareholder *financial* gain.

The 2019 Business Roundtable Statement and Emerging Consensus

Last August, the Business Roundtable (BRT) issued a statement on the *purpose* of the corporation. In the statement, almost 200 chief executive officers of some of our nation's largest corporations committed to lead their companies for the benefit "of all stakeholders – customers, employees, suppliers, communities and shareholders." Yes, shareholders were listed last and given equal footing as the other stakeholders. The BRT statement represented a departure from other BRT statements issued since 1997 that have endorsed principles of shareholder primacy – that is, that corporations exist principally to serve shareholders.[3]

Although rightfully newsworthy, the 2019 BRT statement is only the latest in a series of pronouncements from prominent corporate leaders, institutional investors, academics, and politicians that have questioned the vitality, and viability, of the shareholder primacy model in light of very real environmental and social challenges that threaten us as a "society" – a convenient term I will use to refer to the aggregate of the core stakeholders in a corporation: shareholders, employees, customers, suppliers, and the members of local communities.

An appropriate consensus seems to be emerging that environmental and social concerns should play a more prominent role in corporate board decision- making. In fact, many boards are ready and eager to embrace that consensus. But as they do, boards and their advisors may on occasion feel challenged by traditional concepts of the duties of directors requiring boards to focus on acting in the best interest of the corporation and its shareholders. As stated by the Supreme Court of Delaware over 30 years ago in an M&A context, a board may have regard for other stakeholders in discharging its duties, but only if there are "rationally related benefits" accruing to the shareholders.[4] At least for now, the law is clear in Delaware that corporate directors must at all times pursue the best interests of the corporation and

its shareholders, and the non-shareholder constituencies and interests can only be considered to the extent they benefit shareholders.[5]

Fortunately, given the flexibility generally afforded to directors under Delaware law, it should not be problematic for a board to conclude in exercising its reasonable business judgment that most decisions it will make on matters of societal concern are rationally related to some financial benefit to its company's shareholders.[6] For example, improving employee salaries will likely lead to a more loyal and productive workforce in the short and long run, which should have positive financial returns to the corporation and its shareholders. Similarly, a food manufacturer that enforces high safety standards at its manufacturing facilities – maybe above minimum legal requirements – can mitigate potentially massive losses that may result from an outbreak that causes tragic human casualties and devalues the brand. And it might be the case that most environmental and social initiatives a board wants to undertake can be similarly linked to and safely pass muster under more traditional applications of Delaware fiduciary duties. However, this analytical framework may on occasion break down and invite a less-than-candid discussion and rationalization among corporate decision-makers.

An Expansive View of Shareholder Value

The deepening embrace of environmental and social concerns by institutional and retail shareholders should offer *additional* support for boards to give proper regard to those concerns without requiring boards to necessarily engage in a potentially artificial exercise of linking an environmental or social initiative to a direct *financial* benefit. Indeed, the notion of shareholder value and benefits may be expanding to reflect more than just the long term economic gain of an imaginary shareholder isolated from the rest of society.

For example, Larry Fink of BlackRock – which manages over $6 *trillion* and is one of the largest shareholders of virtually every major U.S. publicly traded company – recently alerted the CEOs of its portfolio companies that "society is increasingly looking to companies, both public and private, to address pressing social and economic issues."[7] Among other things, Fink asked CEOs to "embrace a greater responsibility to help workers navigate retirement, lending their expertise and capacity for innovation to solve this immense global challenge." And based on anecdotal evidence, asset managers of various sizes are, with increasing frequency, making similar statements, in many cases pressed by existing or prospective clients to focus on environmental and social issues as part of their diligence and investment strategy. None of these statements, individually or collectively, *mandate* under the law that a board of directors take any specific action, but they do help show that societal and environment concerns have inherent value and benefit shareholders and can be considered by boards in decision-making (again, without direct and express linkage to a benefit to shareholder financial gain).[8]

Long-term financial gain will unquestionably continue to be the primary driver of investing and should necessarily be the main driver of board decision- making. But it also seems proper that the law recognize changes in how shareholders may value and benefit from non-financial considerations. By doing so, we can avoid having to declare shareholder primacy dead before giving meaningful consideration of environmental and social issues in the boardroom.

An expansive view of shareholder value is not a cure-all for the deep environmental and social issues afflicting our nation. Such a view has important limitations, including that it is only as good as institutional and other shareholders' willingness to affirmatively embrace non-financial values and benefits that align with those of society. And, maybe more important, such a view requires the willingness of shareholders, especially large money managers with so-called permanent capital, to support corporate boards that stand behind those values and benefits when challenged by an activist or other dissident seeking to implement a short-term agenda.

Possible Concerns

Two obvious concerns arise.[9] One is the possibility that an expansive view of shareholder benefits will throw

corporate boards and decision-making into disarray, as otherwise competent executives are challenged to weigh the non-financial benefits to shareholders of a particular environmental or social initiative. But directors already enjoy, and understand, the broad deference given by Delaware courts to their judgment in weighing multiple scenarios and variables that can rarely be reduced to a single number or statistic. Adding a non-financial dimension to the overall calculus should not result in chaos, and any final decision should be protected by the business judgment rule as long as it is well-informed and properly documented by the board and its advisers. The development of the record will certainly be aided by corporations that seek to understand shareholder views and concerns regarding environmental and social matters, as well as by large institutional holders that clearly and publicly articulate their views on these issues, as Fink recently did. And, finally, shareholders can vote out of office a board that deviates from what they believe is the adequate balance of financial and non-financial considerations.

The second, and in my view more legitimate, concern is that an expansive definition of shareholder value could be exploited by some corporate actors as a means to justify decisions that are in reality driven more by self-interest than shareholders' interest. Take, for example, a board that hides behind a desire to preserve its "culture" as a reason to close its doors to a much needed outside capital infusion. I believe those are legitimate concerns that Delaware courts are well-equipped to identify and police.[10] Boards are already well-advised to be adequately introspective and identify situations that could impede them from acting with independence and in the best interest of the corporation and its shareholders. And again, shareholders will have a say at the next annual meeting when they cast a vote on the incumbent slate.

Conclusion

Ultimately, I believe that the legal concept of a corporation primarily serving its shareholders should not be inconsistent with a notion of "value" not tied to the bottom line. Corporations and long-term institutional shareholders (the holders of permanent capital) will benefit themselves and society by openly discussing these matters and creating a clear record for directors around the importance of environmental and social concerns. That is certainly not a long- term cure to deep societal concerns requiring even bolder action,[11] but it may give further comfort to corporate boards that want to consider these matters within the existing legal framework.

ENDNOTES

[1] The author is mindful that the Delaware General Corporation Law uses the nomenclature "stockholders" instead of "shareholders." Notwithstanding the focus of this piece on Delaware law, for convenience I have chosen to use the term "shareholders" given the continuous references here to the more expansive term "stakeholders."

[2] For purposes of this piece I will use "social" to include initiatives and concerns regarding employee matters, which is arguably in this day and age the most pressing social issue for a corporation and its board.

[3] It is important to note that the 2019 BRT statement, like its predecessors, does not purport to be a description of Delaware law, but rather a statement by its signatories of their view of corporate purpose.

[4] *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173 (Del. 1986).

[5] Not surprisingly, there is a robust body of scholarly work on the subject. Just to cite a couple of examples, see David G. Yosifon, The Law of Corporate Purpose, 10 Berkeley Bus. L.J. 181 (2013); and Strine Jr., Leo E., The Dangers of Denial: The Need for a Clear-Eyed Understanding of the Power and Accountability Structure Established by the Delaware General Corporation Law (2015). Wake Forest Law Review, Vol. 50, Pg. 761, 2015; U of Penn, Inst for Law & Econ Research Paper No. 15-08. Available at SSRN: https://ssrn.com/abstract=2576389.

An argument has been advanced that the recurring ref-

erences in Delaware's statute and case law to directors owing fiduciary obligations to "the corporation and its shareholders" may evidence that directors do not owe their duties to shareholders alone but can serve other stakeholders as well. See e.g. David Millon, Two Models of Corporate Social Responsibility, 46 Wake Forest law Review, 523, 526 (2011). The view is somewhat tantalizing, but as of today appears inconsistent with Delaware case law and the power structure established by the corporate statute. See also Strine, Leo E. Jr., "Corporate Power is Corporate Purpose II: An Encouragement for Future Consideration from Professors Johnson and Millon" (2016). Faculty Scholarship at Penn Law. 1721. https://scholarship.law.upenn.edu/faculty_scholarship/1721.

[6] In fact, the Delaware Supreme Court's recent decision in *Marchand v. Barnhill*, 212 A.3d 805 (Del. 2019) illustrates the perils of boards failing to properly oversee compliance functions directly related to the interests of other stakeholders.

[7] Larry Fink's Letter to CEOs, available here. Incidentally, Fink was one of the signatories of the 2019 BRT statement, along with Tim Buckley, president and CEO of Vanguard, an investment adviser with over $5.3 trillion in assets under management.

[8] It is appropriate to acknowledge that some asset managers' calls for an environmental and social agenda may ultimately be driven by what they believe generates better profits in the long run. Or it might be that they need to attract investments from their current or prospective clients. (I do find of interest the Deloitte survey cited by Fink in his 2019 letter to CEOs, which indicates that when millennial workers were asked what the primary purpose of business should be, 63 percent more of them said "improving society" than said "generating profits.") In any event, I do not believe that it should be relevant for a review of a corporate board's actions to discern what motivates the value and benefits views of individual shareholders.

[9] I will conveniently side step a discussion of change-of-control and M&A matters in general, as I believe (maybe out of an exaggerated sense of self- importance) that those have properly required special treatment under Delaware law and raise unique issues of fact and law. I will also skip the less interesting, and in my view superfluous, discussion of whether an expansive view of shareholder value could lead to some socialist reconceptualization of the American corporate system. Many of us enjoy watching Gordon Gekko's passionate "Greed is Good" speech in the movie *Wall Street* (1987) (https://m.youtube.com/watch?v=6bbzwJ0Sx48), but some of us also believe that intelligent economic and societal actors can competently balance the interests of wealth maximization and doing what is right for the environment and society, whether acting in our individual capacity or as fiduciaries of a third party.

[10] For example, in *eBay Domestic Holdings, Inc. v. Newmark*, 16 A.3d 1 (Del. Ch. 2010), the Delaware Court of Chancery properly recognized a situation in which the founders of craigslist tried to justify certain corporate actions on the basis that they were intended to preserve craigslist's "culture." Instead, the court's recitation of the facts makes clear that the invocation of a corporate culture that had to be defended was really a legal artifice to justify more mundane imperatives of protecting the founders' control of craigslist. The court in eBay does note that "[t]he corporate form … is not an appropriate vehicle for purely philanthropic ends," and that corporate directors' standards "include acting to promote the value of the corporation for the benefit of its shareholders." Such statements appear unremarkable and fully consistent with a conceptual framework that continues to give shareholders primacy but allows for a broader view of what shareholders value.

[11] It appears that, at least on matters of environmental concern (and a looming environmental catastrophe), we may be running out of time.

This post comes to us from Eduardo Gallardo, a partner in the New York office of Gibson Dunn & Crutcher, who specializes in mergers & acquisitions and corporate governance. The opinions in this piece are solely his and do not necessarily represent the views or opinions of Gibson Dunn or any other partner of the firm.