A Middle Way to Good Corporate Governance

Photo: Leslie Barbaro

Former Chief Justice Leo E. Strine Jr. weighs in on stakeholder vs. shareholder primacy.

BY DOUG RAYMOND

A current hot debate among governance professionals concerns shareholder vs. stakeholder primacy. Should business corporations pursue shareholder wealth maximization or broader societal interests beyond shareholder returns? This debate is taking place in boardrooms, in the political sphere and among governance mavens. Recently, The Walt Disney Company was involved in what became a very politicized debate that reportedly contributed to the replacement of its CEO. The stakes can be high for boards that take on issues beyond those directly impacting the company.

In a forthcoming article for *The Business Lawyer*, titled "Good Corporate Citizenship We Can All Get Behind? Toward a Principled, Non-Ideological Approach to Making Money the Right Way," former Delaware Supreme Court Chief Justice Leo E. Strine Jr. suggests a possible path forward and proposes a new framework for good corporate citizenship while retaining the primacy of the stockholder. Strine's approach focuses on what he sees as the "most heated part of the debate … the intersection of corporate power and voice and controversial issues of general social and political polity."

Strine starts with fundamental principles of corporate law: that the board of directors has the authority to set corporate policy and to oversee how management implements that policy. That authority extends to corporate policy on political and social issues — notwithstanding the diverse and even conflicting views on such issues that management, employees and other stakeholders may have. This authority to set corporate policy is quite expansive, cabined only by the board's fiduciary obligations and the rights of shareholders to implement select changes, such as a change to the charter or a merger. As Strine observes, absent a conflict of interest in the boardroom, these are weak restraints, particularly because any policy adopted by the board need only further the shareholders' best interests on some rational basis. These sorts of decisions are a textbook example of business judgment of the board. As any law student can tell you, any doubts are almost invariably resolved in favor of the board.

Setting Policy Is in the Board's Purview

Some argue that the shareholder/stakeholder debate can be resolved whenever a majority of shareholders (or their proxy advisors, such as Glass Lewis and ISS) can speak with a unified voice. But even in these companies, the responsibility to set policy rests with the board and not the shareholders (other than the small group of statutory "close corporations," whose shareholders may have this responsibility). Strine argues that directors must focus solely on shareholder returns but in doing so should also consider how the corporation's activities impact other important constituencies who are integral to the success of the business, such as shareholders, employees, consumers, creditors and communities. Stockholders live in the "real world" and require a healthy environment, a stable political system and a workforce that can feed their family. For the chief justice, this recognition forms the basis of taking a broader perspective. After considering this broader community, a board could properly take a stance on an external social or political issue, if the board decides that the issue has direct relevance. "The full board should have to weigh and bear responsibility for any corporate position," Strine writes. Additionally (and ideally), corporate political spending should be eliminated or implemented only under a plan that has been approved by a supermajority of shareholders and is fully aligned with the corporation's own stated values. Similarly, a decision to boycott a particular jurisdiction should be made only with supermajority shareholder approval.

Strine also suggests that institutional investors play an important role in achieving good corporate citizenship. Specifically, "institutional investors can use [a] simple, but important, overarching consideration to help them — their clients' economic interests are broader than any single portfolio company's narrow profit interest." Against that backdrop, Strine identifies similar criteria for institutional investors:

- Institutional investors should "[i]dentify reasonable expectations for portfolio companies to create sustainable value the right way, and the conduct expected of them toward their workforce writ large (including contracted workers), their communities of operations, their consumers and the environment."
- They should channel their efforts toward those issues about which there is less division and over which the corporation has more responsibility in the first place. They should demand that corporations adopt many of the checks and guardrails outlined above.
- They should insist that if a corporation takes positions on social or political issues, it not only should allow its workforce to hold contrary views but also should honor the religious and political diversity of its workforce and customers, "by ensuring an environment and culture of mutual respect that welcomes participation by all Americans of good faith."

Strine's model seeks to thread a middle path and encourage boards to expand beyond a wholly internal focus. But while this solution may be attractive to some boards, others will be unwilling to concede that shareholders should remain the exclusive focus. For this group, Strine's proposal may be a half-measure. But while the debate will continue, boards today need to decide how to respond to the social and political pressures being raised, and how they will justify their actions or inactions on these important issues.

The overall model proposed by Strine — including roles for corporations and institutional investors — boils down to an elegant point: "encouraging respectful treatment of all corporate stakeholders in the pursuit of sustainable profit." In Strine's words, that's how corporations can "make money the right way." Just as each board has to answer for itself whether it chooses to weigh in on certain political and social issues, each board will also have to answer for itself whether it should adopt Strine's approach based on its own objectives. But in answering either question, we still start in the boardroom.

Ultimately, although Strine maintains that all Americans can get behind his bottom-line goal of making money the right way, his approach may not be one that all boards will support. But in any event, boards must choose how they will address these issues and how they will consider the interests of stakeholders other than shareholders in making that decision. Strine's approach provides a useful proposal that will likely trigger further thoughtful discussion and guide boards as they navigate these difficult issues. ■

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