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Exploring the G in ESG: Governance in Greater Detail – Part I

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There is increasing evidence of the link between ESG and financial outperformance as better data quality, standardized data, longer data history, and heightened interest in assessing the materiality of ESG drives continued research. However, there is already substantial empirical evidence to suggest that the “G” aspect of ESG ultimately yields better corporate returns.

Governance data, unlike environmental or social data, has been compiled for a longer period of time and the criteria for what comprises good governance and its classification has been more widely discussed and accepted. Harvard researchers Gompers, Ishii, and Metrick (2003)^[1] constructed a Governance Index (G-Index) consisting of 24 governance provisions that weaken shareholder rights and ranked companies based on their scores.

Subsequent research from Bebchuk, Cohen, and Ferrell (2009)^[2] identified six corporate governance provisions that are associated with what is considered poor governance and that negatively affect valuation. These six provisions are called the “E-Index” (E for entrenchment), and while they (Bebchuk, Cohen, and Wang, 2012) ^[3] found that both the G-Index and E-Index would have resulted in abnormal returns in the 1990s, the premium dissipated in the 2000s as the markets learned to distinguish between firms with good governance and those with poor governance and price these discrepancies accordingly.

Through a blog series on governance, we will be detailing what the categories and criteria are that define good governance. For sustainability research, S&P Dow Jones Indices partners with RobecoSAM, an asset manager known for its Corporate Sustainability Assessment (CSA), resulting in an overall sustainability score for companies in addition to the three underlying dimension scores that measure their environmental, social, and governance performance.

Economic Dimension Score

Based on RobecoSAM’s definition, the governance score is referred to as the economic dimension score (EDS), as it evaluates the corporate governance performance of companies but includes additional key measurements that evaluate the quality of a company’s management systems as well as its ability to manage long-term risks and opportunities. In order to understand the G component of ESG and how it affects stock performance, it is helpful to delve deeper into what constitutes good governance.

There are eight specific EDS criteria as outlined in Exhibit 1. The first is **corporate governance**, which evaluates the systems that ensure a company is managed in the interests of its shareholders (including minority shareholders).

Exhibit 1: The Eight Criteria for Economic Dimension Scores

1. Corporate Governance	<ul style="list-style-type: none"> • Board Structure, Diversity, Effectiveness, Experience, Tenure • Executive Compensation • Management Ownership Requirement
2. Codes of Business Conduct	<ul style="list-style-type: none"> • Codes of Conduct • Corruption and Bribery • Systems/Procedures • Reporting on Breaches
3. Risk and Crisis Management	<ul style="list-style-type: none"> • Risk Governance and Culture • Sensitivity Analysis and Stress Testing • Emerging Risks
4. Supply Chain Management	<ul style="list-style-type: none"> • Supply Chain Awareness and Risk Exposure • Supplier Code of Conduct • ESG Integration in Supply Chain
5. Tax Strategy	<ul style="list-style-type: none"> • Tax Strategy • Tax Reporting • Tax Governance
6. Materiality/7. Policy Influence/8. Impact Measurement	<ul style="list-style-type: none"> • Materiality • Contributions • Impact Valuation and Disclosure

Source: RobecoSAM. Chart is provided for illustrative purposes.

Codes of business conduct addresses business ethics and whether the company's code of conduct and compliance practices are designed to prevent bribery and corruption in the organization. Companies active in countries with weak anti-corruption laws are exposed to additional reputational and legal risks.

Risk and crisis management examines the effectiveness of the company's risk management organization and practices, including the independence of risk management from business lines as well as the identification of long-term risks, their potential impact, and the company's mitigation efforts.

Supply chain management is becoming increasingly important as companies expand to operate on a global level. When a company outsources its production, services, or business processes, it also outsources its own corporate responsibilities and its reputation. Companies need to have strategies in place to manage the associated risks and opportunities posed by their supply chain.

The **tax strategy** criteria examines the degree to which the company has a clear policy on its approach to taxation issues and an awareness of the extra-financial risks associated with the company's tax practices.

The **materiality score** aims to assess the company's ability to identify the sources of long-term value creation, understand the link between long-term issues and the business case, develop long-term metrics, and transparently report these items publicly.

In the **policy influence criteria**, RobecoSAM evaluates the amount of money companies are allocating to organizations whose primary role is to create or influence public policy, legislation, and regulations. Companies are also asked to disclose the largest contributions to such groups.

Impact measurement and valuation strives to assess whether companies have business programs for social needs, such as strategic social investments, and if they are measuring and valuing their broader societal impacts with metrics. Companies need to analyze the impacts of externalities that are not currently reflected in financial accounting, but which, over time, may have the potential of becoming priced in.

As discussed and laid out in this blog, the EDS comprises more than a traditional governance score. The inclusion of risk and crisis management, supply chain management, and tax strategy criteria differentiates the RobecoSAM EDS from a traditional governance score that relies heavily on more standard corporate governance metrics. In the next blog in this series, we will examine whether the EDS contains risk/return information and how it may impact future stock performance.

DIVERSITY, ESG, AND LATENT BOARD POWER

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ABSTRACT

Corporations have traditionally treated shareholder wealth as primary. In recent years, however, cracks in this hierarchy have appeared. An enlargement of purpose is now visible across corporate governance, from the new emphasis on board diversity to the surge in environmental, social, and governance ("ESG") investing, to the growing success of benefit corporations. But in legal terms, corporate policy change requires more—specifically, the approval and participation of the board of directors.

The vast normative and empirical literature on diversity, ESG, and the stakeholder theory of the firm overlooks some key operational questions and tensions, which this Article frames and develops for the first time. How might differently-constituted boards of directors approach tradeoffs between shareholder wealth and social welfare differently? What levers can they reach for to broker competing claims to priority? What constrains them?

Exploring the rising pluralism of corporate purpose through this lens—legally, the one that matters most—suggests the board's powers are far more capacious than is commonly appreciated. As the board's make-up, mission, and voting base broaden, its historical norm of deferring to CEOs may prove unstable. This Article provides a novel account of how boards might recover their latent powers and promote diversity and ESG in corporate law.

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I. INTRODUCTION

"I cannot recall a time," wrote Blackrock CEO Larry Fink in his 2021 letter to CEOs, "where it has been more important for companies to respond to the needs of their *stakeholders*."³ Fink's use of the term "stakeholder" was no accident. In corporate law, it signifies a broader universe of concern than shareholder profit, encompassing the interests of employees, customers, community members, suppliers, and creditors. As chief of the world's largest asset manager, Fink was quick to connect the dots to shareholder return—"companies with better ESG profiles are performing better than their peers," he contended, "enjoying a 'sustainability premium'"⁴—but the message was unmistakable. "We have long believed

³Larry Fink, *Letter to CEOs*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Jan. 30, 2021), <https://corpgov.law.harvard.edu/2021/01/30/letter-to-ceos/> (emphasis added).

⁴*Id.*

that our clients, as shareholders in your company, will benefit if you can create enduring, sustainable value for *all* of your stakeholders."⁵ He also asked for increased disclosure around companies' diversity, equity, and inclusion efforts.⁶

Fink's letter in many ways embodies several gathering forces in corporate governance. These include growing interest in board diversity, environmental, social, and governance (collectively, "ESG") investing, and stakeholder-centric visions of the firm. Together, these changes suggest the possibility of a sea change in the purpose of the corporation.

In legal terms, any reform of corporate purpose would require the cooperation of boards of directors and in particular their deployment of the levers of board authority. These two are easily conflated, but they are not the same: as an academic and doctrinal subject, board power has not enjoyed the same level of attention as questions relating to board independence, competence, or composition. However, the emerging pluralism of purpose in corporate law⁷ needs operational analysis to supplement its empirical and normative dimensions. This Article identifies, develops, and begins to fill that gap.

The law vests ultimate corporate authority in the board of directors,⁸ but an extensive review of modern corporate law literature shows this power to be dormant.⁹ Boards at public companies are largely dominated by CEOs and their management teams in terms of information flow.¹⁰ The

⁵*Id.*

⁶*Id.*

⁷See generally Geoffrey Swenson, *Legal Pluralism in Theory and Practice*, 20.3 INT'L STUDIES REV. 438 (2018). Other scholars have applied the term pluralism to corporate purpose, mostly in the context of entity choice. See Lyman Johnson, *Pluralism in Corporate Form: Corporate Law and Benefits Corps.*, 25 REGENT U. L. REV. 269 (2012) (discussing pluralism in corporate form).

⁸See DEL. CODE Ann. tit. 8, § 141 (2020) ("The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors," subject to limited exceptions). Delaware is the dominant United States corporate law jurisdiction, but similar statutes control in other states. See MODEL BUS. CORP. ACT § 8.01(b)(2016) ("all corporate powers shall be exercised by or under the authority of the board of directors, and the business and affairs of the corporation shall be managed by or under the direction, and subject to the oversight, of the board of directors," subject to limited exceptions).

⁹See generally Gregory H. Shill, *The Independent Board as Shield*, 77 WASH. & LEE L. REV. 1811 (2020); Gregory H. Shill, *The Golden Leash and the Fiduciary Duty of Loyalty*, 64 UCLA L. REV. 1246, 1264 (2017); Usha Rodrigues, *The Fetishization of Independence*, 33 J. CORP. L. 447, 451 (2008); MELVIN A. EISENBERG, *THE STRUCTURE OF THE CORPORATION: A LEGAL ANALYSIS* (1976).

¹⁰Lisa M. Fairfax, *The Uneasy Case for the Inside Director*, 96 IOWA L. REV. 127, 165 (2010) (noting evidence that "many directors lack the knowledge and expertise to

modern board's many deficits,¹¹ however, do not merely inhibit its effectiveness. Rather, because of the board's legal status as an independent monitor, courts presumptively defer to its decisions—imbuing inadequately informed or excessively passive board decisions with a fig-leaf quality that shields the CEO and other top executives.¹² Thus, boards routinely approve enormous sums in compensation for CEOs¹³ and protect them from hostile takeovers that would cost them their jobs,¹⁴ even when doing so costs shareholders money—and courts typically dutifully abstain from intervening.

This pattern has been the subject of widespread criticism. Critics tend to divide into two groups: those who favor shareholder power as a counterweight to the board,¹⁵ and those who advocate minimally

sufficiently appreciate the complexities associated with their business, and that such lack of knowledge impedes the effectiveness of their oversight").

¹¹ Gregory H. Shill, *The Independent Board as Shield*, 77 WASH. & LEE L. REV. 1811, 1843-62 (2020)

¹² See generally Gregory H. Shill, *The Independent Board as Shield*, 77 WASH. & LEE L. REV. 1811 (2020); J. Robert Brown, Jr., *Disloyalty without Limits: "Independent" Directors and the Elimination of the Duty of Loyalty*, 95 KY. L. J. 53, 53-54 (2006) ("Delaware courts have all but eliminated meaningful limits on self-interested transactions. Loans to officers and directors, for example, need not meet commercially reasonable standards; top officers may be paid excessive sums with no judicial oversight of the fairness of the amount; and contributions may be made to charities favored by the CEO almost without limit.").

¹³ See *In re Info USA, Inc. S'holders Litig.*, 953 A.2d 963, 984 (Del. Ch. 2007) (noting judicial policy of treating executive compensation as "a matter best determined by the good faith judgments of disinterested and independent directors, men and women with business acumen appointed by stockholders precisely for their skill at making such evaluations."); Gregory H. Shill, *The Independent Board as Shield*, 77 WASH. & LEE L. REV. 1811, 1879-82 (2020); Joseph M. McLaughlin, *Corporate Litigation: Stockholder Challenges to Executive Compensation*, SIMPSON THACHER & BARTLETT LLP (2012) (observing that "[a] stockholder derivative plaintiff challenging most board decisions regarding executive compensation or severance payments confronts a pleading Everest").

¹⁴ See Gregory H. Shill, *The Independent Board as Shield*, 77 WASH. & LEE L. REV. 1811, 1872-79 (2020); Julian Velasco, *The Enduring Illegitimacy of the Poison Pill*, 27 J. CORP. L. 381, 383 (2002) ("The poison pill derives its effectiveness from this deterrence value—the incumbent management can remain in power because the hostile bidder cannot afford to trigger the poison pill."); *id.* at 384-85 ("By severely restricting the market for corporate control, the poison pill has rendered management significantly less accountable to shareholders. Management need not be as concerned with the shareholders' interests if it is capable of resisting even the most lucrative hostile takeover offers.").

¹⁵ See e.g., Lucian Arye Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 851 (2005) ("[S]hareholders should have the power, subject to certain procedural requirements, to initiate and adopt rules-of-the-game decisions to amend the charter or to reincorporate in another state."); Mark J. Roe, *Corporate Law's Limits*, 31 J. LEGAL STUD. 233, 242-43 (2002); Ronald L. Gilson, *Unocal Fifteen Years Later (and What We Can Do About*

constrained board discretion.¹⁶ Underlying the positions of these dueling ideological mythologists (in the words of former Delaware Supreme Court Chief Justice Leo Strine) is an implicit agreement on a basic fact: that the board is the sun around which the planets of corporate governance revolve.¹⁸

This Article seeks to recover the mechanics of board power and situate them in the context of modern corporate governance debates. What might be the effect if a board were to flex its muscles to the full extent of its powers? This issue has largely not been the focus of scholars to date, the tremendous depth and breadth of board legal authority gives it natural importance, and recent shifts in the capital markets and regulatory environment suggest it will soon become more urgent.

Boards have been the dominant focus of corporate governance scholars—and to some extent regulators—for nearly a century. These efforts culminated in major structural change: in the 1970s, a new norm was born—and beginning in 2003, a mandate issued—to formally subordinate CEOs and other managers to a board of directors that consists mostly of outside independent directors. This transformed the board from an assemblage of top managers whose actions as board members were merely an extension of their regular management responsibilities to an autonomous, separate organ.

As a result of this change, the public company board is now staffed almost entirely by outside independent directors who do not report to the CEO and, in fact, have the power to fire her. Despite this change, the norm of de facto management control has remained sticky. On the horizon, though, are more fundamental changes to the board. Among these are movements to diversify the board, add representatives of non-shareholder constituencies, such as unions, and expand the board's mandate beyond shareholder primacy. While an earlier generation of changes vested considerable potential energy in boards, that energy never went kinetic.

This Article describes the latent powers of the board and situates them in longstanding and current corporate governance debates alike.

It), 26 DEL. J. CORP. L. 491, 507 (2001); Melvin A. Eisenberg, *The Structure of Corporation Law*, 89 COLUM. L. REV. 1461, 1479–80 (1989).

¹⁶See e.g., Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 551 (2003); William W. Bratton & Michael L. Wachter, *The Case Against Shareholder Empowerment*, 158 U. PA. L. REV. 653, 659–60 (2010); Martin Lipton & William Savitt, *The Many Myths of Lucian Bebchuk*, 93 VA. L. REV. 733, 734 (2007).

¹⁸Leo E. Strine, Jr., *Can We Do Better by Ordinary Investors? A Pragmatic Reaction to the Dueling Ideological Mythologists of Corporate Law*, 114 COLUM. L. REV. 449, 474 (2014).

While board diversity has been an official goal of many boards for some time, high-profile social movements such as **Me Too** and **Black Lives Matter** have vaulted board diversity to a top-tier priority, especially after the killing of George Floyd in 2020. The state of California as well as the Nasdaq stock exchange have established a presumption or requirement of diversity on public company boards. In the market for corporate influence, proxy advisors, institutional investors, and investment banks have all signaled accountability for failures to increase board diversity.¹⁹ At the same time, bills introduced in Congress by Senators Elizabeth Warren (D-MA)²⁰ and Tammy Baldwin (D-WI)²¹ in recent years seek to require representation of non-shareholder stakeholders, such as employee unions, to the board. Though their legislative prospects are uncertain, polling suggests majority popular support for a measure of this type.²² The push towards greater accountability to stakeholders of all types can also be seen in the rise²³ of benefit corporations, which are not constrained by the profit maximization edict of their more traditional brethren.²⁴ Most of all, conventional corporations themselves are moving in this direction to a growing degree.

This Article seeks to anchor these debates in the prospect of a different, emboldened board. To date, corporate boards have been constituted only as representatives of shareholders, and as homogeneous—overwhelmingly old, white, male, and wealthy—

¹⁹See Richa Joshi, *Board Diversity: No Longer Optional*, Harv. L. Sch. F. on Corp. Governance (Oct. 11, 2020), <https://corpgov.law.harvard.edu/2020/10/11/board-diversity-no-longer-optional>.

²⁰See Accountable Capitalism Act, S. 3348 – 115th Cong. (2018).

²¹See Reward Work Act, S. 2605 – 115th Cong. (2018).

²²Shom Mazumder, *Americans Across the Political Spectrum Support Increasing Worker's Role in Corporate Decision-Making*, DATA FOR PROGRESS (Feb. 14, 2019), <https://www.dataforprogress.org/blog/2018/12/14/employee-governance> (indicating 53 percent support among likely voters for a proposal mandating employee representation on corporate boards).

²³Michael R. Littenberg, et al., *Delaware Public Benefit Corporations—Recent Developments*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Aug. 31, 2020), <https://corpgov.law.harvard.edu/2020/08/31/delaware-public-benefit-corporations-recent-developments>; Leo E. Strine, *Toward Fair and Sustainable Capitalism*, 12-13 (Roosevelt Inst. Working Paper, Aug. 2020) https://rooseveltinstitute.org/wp-content/uploads/2020/08/RI_TowardFairandSustainableCapitalism_WorkingPaper_202008.pdf (advocating for the increased role of benefit corporations, especially among larger companies).

²⁴See DEL. CODE ANN. tit. 8, § 365(a) ("The board of directors shall manage or direct the business and affairs of the public benefit corporation in a manner that *balances the pecuniary interests of the stockholders, the best interests of those materially affected by the corporation's conduct, and the specific public benefit or public benefits identified in its certificate of incorporation.*" (emphasis added)).

representatives at that. If boards diversify in membership, purpose, or both, new directors may have reason to revisit the instruction manual for the position and attempt to put its grants of authority to work. This Article maps the mostly dormant sources of board power and integrates them into current debates.

We proceed in five additional parts. Part II presents current efforts to transform the board's purpose as an extension of efforts to enhance its legitimacy. This Part provides a historical perspective, tracing the board's transition from management functionary to distinct organ—a change that left it with more power on paper if not always in practice. Crucially, the increase in power would not have been possible without a philosophical change in the board's role from managerial advisor to independent monitor performing a quasi-regulatory function. Next, Part III conceptualizes and provides an account of the allocation of important business and governance powers of the firm as between shareholders and the board. These rules furnish a kind of constitution of the board, consisting of both legal and market provisions.

Changes in the purpose and makeup of the board now unfolding render the scope of board authority newly salient. Part IV explores board legitimacy challenges stemming from a lack of diversity and representativeness on the board, as well as governmental responses attempting to address it. It then examines proposals to shift the U.S. system towards a stakeholder model. Part V highlights recent trends in ESG investing, including the Business Roundtable's endorsement of a stakeholder vision of the firm. Part VI considers how latent powers of the board might give commitments on diversity, ESG, and stakeholderism new salience. The Article then concludes by repositioning the current and classical debates of corporate governance within the bounds of potential board power.

II. THE BOARD AS DECIDER

Shareholders have no role in the day-to-day management of the corporation.²⁵ Instead, the Delaware General Corporation Law ("DGCL"), the nation's leading corporate law statutory regime, assigns responsibility

²⁵See generally Stephen M. Bainbridge, *The Board of Directors As Nexus of Contracts*, 88 IOWA L. REV. 1, 4 (2002) (noting that "shareholders have essentially no power to initiate corporate action and, indeed, are entitled to approve or disapprove only a very few board actions").

for managing the corporation to the board of directors,²⁶ and other states follow the same rule.²⁷ The board runs the corporation for the benefit of the shareholders and owes fiduciary duties to that constituency alone during solvency.²⁸ This purpose is traceable to the power of shareholders to replace (as well as sue) directors and managers for perceived departures from their duties to the firm, a power that biases corporate purpose in favor of profit maximization.²⁹ While this concept admits of some flexibility, given Delaware law's deference to the business judgment of the board in how it carries out its mission, it remains true that the board's focus and mandate is to do what is best for the economic interests of shareholders of the corporation—and violation of this stricture gives rise to nearly all shareholder rights of action.³⁰

The public company board, now composed of independent outsiders and granted great power as monitors, historically consisted of insider directors who were neither independent nor powerful.³¹ As related in this Part, this transition from figurehead to decider was aimed at maximizing shareholder wealth.³²

In the early years, corporations were dominated by the CEO, who was frequently the founder of the corporation, one of its largest shareholders, or both.³³ As changes in transportation and communication technology helped facilitate the rise of the national and later global corporation, the shareholder base became correspondingly more dispersed

²⁶DEL. CODE ANN. tit. 8, § 141(a) (2019).

²⁷*See id.* ("The business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors," subject to limited exceptions). While Delaware is the dominant United States corporate law jurisdiction, similar statutes control in other states. *See* MODEL BUS. CORP. ACT § 8.01(b)(2016) ("all corporate powers shall be exercised by or under the authority of the board of directors, and the business and affairs of the corporation shall be managed by or under the direction, and subject to the oversight, of the board of directors," subject to limited exceptions).

²⁸*See, e.g.*, Elizabeth Pollman, *Corporate Disobedience*, 68 DUKE L.J. 709, 755 (2019) (observing that "[c]orporate directors and officers owe fiduciary duties to the corporation and its shareholders—not to the government or society writ large.") (internal citation and footnote call omitted).

²⁹Leo E. Strine, Jr., *Corporate Power Is Corporate Purpose I: Evidence from My Hometown*, 33 OXFORD REV. OF ECON. POL'Y 176, 178-79 (2017) ("those who run corporations owe their continued employment . . . to the only constituency the corporate law establishes—stockholders.").

³⁰*Id.*; *see* DEL. CODE ANN. tit. 8, § 122(9) (2019).

³¹*See* Jeffrey N. Gordon, *The Rise of Independent Directors in the United States, 1950-2005: Of Shareholder Value and Stock Market Prices*, 59 STAN. L. REV. 1465, 1516 (2007).

³²*Id.* at 1520.

³³*Id.* at 1511-14.

and less capable of monitoring management.³⁴ The CEOs and other insider-executives who ran the board had little incentive to challenge the actions of management (which would have meant challenging themselves) and faced little shareholder pressure to do so.³⁵ As a result, the board acted as an extension of the CEO.³⁶ Indeed, in many of the canonical early corporate law cases, courts dismissed—or simply did not discuss—the role of the board in a challenged transaction, likely because the board had little to no separate say in the matter.³⁷

The growth in board power began during the 1970s and 1980s in the midst of the hostile takeover boom and on the heels of several corporate scandals.³⁸ During this time, the board began to shift from directors who lacked any incentive to dispute management decisions (and indeed may have been managers of the corporation themselves) towards independent directors.³⁹ These independent directors functioned as outside monitors of the corporation, designed to ensure that management was acting in the best interests of the shareholders.⁴⁰ Today, securities law and stock exchange rules require that a majority of the board members meet "independence" standards.⁴¹

The independent board created the potential for a sea change that has so far failed to materialize, but greater heterogeneity in corporate purpose might enable it to finally take flight. The role of independence, mandatory in public companies since 2003,⁴² is critical here. Prior to independence, the notion of a distinct board perspective was nonsensical. Management and the board were united in perspective and often identical in composition.⁴³ Unlike more recent debates around management

³⁴Shill (2020), *supra* note 9, at 1822.

³⁵See Gordon, *supra* note 31, at 1516.

³⁶EISENBERG, *supra* note 9, at 139-41 (contending that the typical board was passive and its functions manager-dominated).

³⁷See *Dodge v. Ford Motor Co.*, 170 N.W. 668 (Mich. 1919); *Shlensky v. Wrigley*, 237 N.E.2d 776 (Ill. App. Ct. 1968); *Graham v. Allis-Chalmers Mfg. Co.*, 188 A.2d 125, 130 (Del. 1963) (stating the board need not create a system of monitoring).

³⁸See Gordon, *supra* note 31, at 1514-15 (summarizing the Penn Central and Watergate scandals).

³⁹*Id.* at 1518; See also EISENBERG, *supra* note 9.

⁴⁰AM. LAW INST., PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 3.03(a) (1994); Stephen M. Bainbridge, Independent Directors and the ALI Corporate Governance Project, 61 GEO. WASH. L. REV. 1034, 1035 (1993).

⁴¹Sarbanes-Oxley Act, 15 U.S.C. § 302 (2002); See N.Y. STOCK EXCH., LISTED COMPANIES MANUAL § 303A.01; NASDAQ EQUITY RULES § 5605(b)(1)(2009); Shill (2020), *supra* note 9, at 1815-16.

⁴²Shill (2020), *supra* note 9, at 1826.

⁴³Gordon, *supra* note 31, at 1468

influence over directors, the insider regime allowed management to appoint, compensate, and evaluate itself.⁴⁴ Thus, any discussion of board power must begin with a sufficient understanding of the development of the board as a distinct decisionmaking body empowered to override management.

This Part will briefly trace the historical development of the board from perfunctory organ to central decisionmaker. Additionally, it will highlight how the independence of the board is a necessary ingredient for any framework that provides the board with the power, representative legitimacy, and mandate to challenge management decisions—and how it paved the way for the reforms underway today.

A. Pre-1970s: The Insider Board

Throughout the first half of the twentieth century, the board's primary role was that of advisor to the CEO and management of the corporation.⁴⁵ Thus, an attractive candidate for a director position was someone with deep knowledge of the specific challenges and needs of the industry, and the business itself. As a result, the board at this time included primarily insiders—senior managers, investment bankers, and outside lawyers who frequently represented and advised the company.⁴⁶ These insiders performed this advisory function more effectively than outside directors, who lacked the deep internal knowledge necessary to provide management with meaningful substantive guidance.⁴⁷ Indeed, viewing the board as an arm of management makes inside directors significantly more attractive than outside candidates. This conception of the board helps explain why, in 1970, only 20 percent of directors were independent.⁴⁸ At that time, there was not yet caselaw establishing a clear legal advantage for adopting a majority-independent board, which would later make

⁴⁴*Id.*

⁴⁵Ronald J. Gilson & Jeffrey N. Gordon, *Board 3.0: An Introduction*, 74 *BUS. LAW.* 351, 355 (2019).

⁴⁶Gordon, *supra* note 31, at 1468.

⁴⁷Lisa M. Fairfax, *The Uneasy Case for the Inside Director*, 96 *IOWA L. REV.* 127, 179–80 (2010) ("Inside directors invest considerable time and resources into the corporation, which translates into superior knowledge about the company. This knowledge means that they are likely to make better decisions even as compared to an independent director who receives similar information because inside directors can put the information in a broader, more nuanced context.")

⁴⁸Gordon, *supra* note 31, at 1565.

independence appealing even before it was required by the major stock exchanges.⁴⁹

The insider board generated criticisms for its risks to shareholders. While insiders could advise the board about specific business matters, they lacked motivation to try and drive down the agency costs inherent in the separation of ownership and control.⁵⁰ This problem—a version of the principal-agent problem, whereby the incentives of management-agents and shareholder-principals are misaligned—has dominated corporate governance scholarship for nearly a century. Senior managers, wearing their director cap, were formally required to provide oversight of themselves and their similarly-situated colleagues.⁵¹ Lawyers and investment bankers were asked to question and monitor the actions of those who oversaw their fees and future business with the corporation.⁵² These insiders had little ability, and even less incentive, to ensure that management was acting in a way that was beneficial for shareholders and not for the managers themselves.

Leading scholars of corporate law in the New Deal era pointed out the agency costs inherent in a managerialist or advisory model of the board.⁵³ In 1934, William O. Douglas (then a professor, and later an Associate Justice of the U.S. Supreme Court) highlighted flaws inherent in the insider board framework.⁵⁴ Managers, accountable only to themselves, were free to divert corporate resources to private ends.⁵⁵

⁴⁹Shill (2020), *supra* note 9, at 1825-26.

⁵⁰See Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 309 (1976) ("Since the relationship between the stockholders and manager of a corporation fit the definition of a pure agency relationship it should be no surprise to discover that the issues associated with the 'separation of ownership and control' in the modern diffuse ownership corporation are intimately associated with the general problem of agency.").

⁵¹William O. Douglas, *Directors Who Do Not Direct*, 47 HARV. L. REV. 1305, 1313 (1934) ("[T]hat power will never be present in experts who have no vote and who are called in by the managers, who work for the managers, and who are limited by the desires of the managers.").

⁵²Gordon, *supra* note 31, at 1468.

⁵³Douglas, *supra* note 51, at 1307; ADOLF A. BERLE & GARDINER C. MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (1932).

⁵⁴Douglas, *supra* note 51, at 1308 ("The managers came to be their own supervisors, and the stockholders were moved into a position of effective subservience to those who by tradition and law were their servants.").

⁵⁵Douglas, *supra* note 51, at 1309 ("In the first place, the board had approved and put into effect two so-called profit-sharing plans entitling officer-directors, directors who were members of the executive committee, and certain employees to a participation in earnings. Pursuant to these plans 'large sums were distributed to executive officers' in 1929 and 1930 as additional compensation in excess of their salaries.' Yet at no time, so it is said, were these plans submitted to the stockholders.").

Douglas' work took up the problem identified in a contemporary and influential tome by Adolf Berle and Gardiner Means⁵⁶ that birthed the field of modern corporate governance.

The limitations of the insider board were highlighted in several of the bedrock corporate law cases of the era.⁵⁷ In *Dodge v. Ford Motor Co.*,⁵⁸ for instance, the Supreme Court of Michigan analyzed the decision of Ford Motor Company to limit the distribution of a special dividend to shareholders, notwithstanding the company's extraordinary profit from the previous year.⁵⁹ In weighing the merits of the suit challenging that decision, the court emphasized the actions and statements of Henry Ford, the corporation's founder, CEO, and controlling shareholder.⁶⁰ Despite having previously noted dividends were the exclusive domain of the *board of directors*,⁶¹ the court stated, "Mr. Henry Ford is the dominant force in the business of the Ford Motor Company. No plan of operations could be adopted unless he consented, and no board of directors can be elected whom he does not favor."⁶² While true a modern court decision would have conducted a separate analysis to determine whether the board acted under the controlling shareholder's control; the court would not immediately have assumed a shared identity between the board and the controller.⁶³ The *Dodge* court, in effect, brushed aside the board's separateness and attributed the motivations of the controller to the corporation as a whole.

⁵⁶ADOLF BERLE & GARDINER MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* (1932).

⁵⁷*See Dodge v. Ford Motor Co.*, 170 N.W. 668 (1919); *Shlensky v. Wrigley*, 95 237 N.E.2d 776 (Ill. App. Ct. 1968); *Graham v. Allis-Chalmers Mfg. Co.*, 188 A.2d 125, 130 (Del. 1963).

⁵⁸*Dodge*, 170 N.W. at 668.

⁵⁹*Id.* at 683 ("When plaintiffs made their complaint and demand for further dividends, the Ford Motor Company had concluded its most prosperous year of business.").

⁶⁰*Id.* (quoting Mr. Henry Ford's dream for the future of Ford Motor Company and treating such dream as the driving force of the company).

⁶¹*Id.* at 682 ("The board of directors declare the dividends, and it is for the directors, and not the stockholders, to determine whether or not a dividend shall be declared.") (internal citations omitted).

⁶²*Dodge*, 170 N.W. at 683.

⁶³Courts have various ways of getting at these questions. For example, in a transaction between a corporation and its controlling shareholder, a board that consists of a majority of independent directors can endow the transaction with business judgment rule protection by constituting a special committee and securing the approval of a majority of the minority shareholders. *See Robert B. Little & Joseph A. Orien, Determining the Likely Standard of Review in Delaware M&A Transactions*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Apr. 28, 2017), <https://corpgov.law.harvard.edu/2017/04/28/determining-the-likely-standard-of-review-in-delaware-ma-transactions-2/>.

In 1968, almost fifty years after *Dodge*, the Illinois Court of Appeals in *Shlensky v. Wrigley* considered a claim against the Chicago Cubs and their owner, Philip K. Wrigley of the eponymous baseball park, alleging that the decision not to install lights at the Cubs' home stadium was a breach of fiduciary duty.⁶⁴ The *Shlensky* court struggled to view the man and the corporate board as separate entities, and found that the decision to install lights at Wrigley Field was squarely within the business judgment of the board.⁶⁵ Tellingly, the court used the motives of the majority shareholder, Wrigley, as justification for the board's decision.⁶⁶ In rejecting the shareholder challenge, it spoke of "the motives assigned to Philip K. Wrigley, and *through him* to the other directors."⁶⁷ *Shlensky*, like *Dodge*, involved a controlling shareholder.

While cases that involve a controlling shareholder may not appear on their face to call for a carefully distinguished analysis of board rather than CEO or controller behavior (since the board ultimately serves at the pleasure of the controller), this wrinkle can be ironed out by incorporating three additional considerations. First, other corporate law chestnuts from the insider-board era follow the same template of noting a decision by a board but then focusing on the conduct of the CEO or president.⁶⁸ Second, and by contrast, recent controlling shareholder cases—decided in the age of the independent board—contain very complex analyses of board behavior, sometimes focusing on specific conversations or transactions between particular directors and the CEO.⁶⁹ Modern courts also scrutinize board (instead of or in addition to CEO) behavior in the context of many other transactions that involve, or raise similar questions to, the presence of a controlling shareholder, for example: shareholder rights plans (or poison pills), deal protections, management buyouts, and related-party

⁶⁴*Shlensky v. Wrigley*, 237 N.E.2d 776, 778 (Ill. App. Ct. 1968) ("Plaintiff further alleges that defendant Wrigley has refused to install lights, not because of interest in the welfare of the corporation but because of his personal opinions 'that baseball is a "daytime sport" and that the installation of lights and night baseball games will have a deteriorating effect upon the surrounding neighborhood.").

⁶⁵*Id.* at 780 ("We are merely saying that the decision is one properly before directors and the motives alleged in the amended complaint showed no fraud, illegality or conflict of interest in their making of that decision.").

⁶⁶*Id.*

⁶⁷*Id.*

⁶⁸*See, e.g., A.P. Smith Mfg. Co. v. Barlow*, 13 N.J. 145 (1953) (noting board decision to authorize a charitable donation, then explaining that decision through the lens of the corporation's president's testimony rather than by dwelling on board action itself).

⁶⁹*See, e.g., Sandys v. Pincus*, 152 A.3d 124, 130 (Del. 2016) (assessing the implications for independence determination for purposes of Delaware law of one director co-owning a plane with the CEO).

transactions.⁷⁰ Third, modern cases that do not involve a controlling shareholder are solely focused on the behavior of the board, as distinguished from that of the CEO.⁷¹

By the 1980s, the legitimacy of board action in transactions presenting the conflicts that conventionally produce litigation hinged almost completely on a determination of the independence of the board or a subset of directors.⁷² Courts in these cases emphasize board independence, diligence, and process—not CEO conduct.⁷³ In the landmark *Paramount v. Time* decision, for example, the Delaware Supreme Court considered whether the Time board breached its fiduciary duties by implementing defensive tactics to defend its acquisition of Warner Communications.⁷⁴ The court first noted twelve of Time's sixteen directors were outside directors. Additionally, the court highlighted the

⁷⁰Shill (2020), *supra* note 9, at 1872–90; Joseph M. Grieco, *The Ever-Evolving Poison Pill: The Pill in Asset Protection and Closely-Held Corporation Cases*, 36 DEL. J. CORP. L. 625, 627 (2011) ("The Delaware courts authorized the use of the poison pill in the 1980s and have continually applied a heightened standard of review, the *Unocal* standard, when the pill is implemented by corporate boards."); Karl F. Balz, *No-Shop Clauses*, 28 DEL. J. CORP. L. 513, 527 (2003) (noting that the more demanding *Unocal* standard applies to the review of deal protections, in particular no-shop clauses); Stephen M. Bainbridge, *Unocal at 20: Director Primacy in Corporate Takeovers*, 31 DEL. J. CORP. L. 769, 821 (2006) (Delaware courts have handled the risk of conflicts in management buyout proposals in part by encouraging "an active role" for independent directors); Virginia Harper Ho, *Team Production & the Multinational Enterprise*, 38 SEATTLE U. L. REV. 499, 515–16 (2015) ("[I]n related party transactions, courts give business judgment rule deference to subsidiary boards that establish their decisional independence."); *Paramount Commc'ns Inc. v. QVC Network Inc.*, 637 A.2d 34, 42 (Del. 1994) ("[T]here are rare situations which mandate that a court take a more direct and active role in overseeing the decisions made and actions taken by directors [such as in defensive measures]. In these situations, a court subjects the directors' conduct to enhanced scrutiny to ensure that it is reasonable.").

⁷¹Examples in this category are legion; two chestnuts appear headed for canonical status akin to *Dodge* and *Shlensky*. See *In re Oracle Corp. Derivative Litig.*, 824 A.2d 917 (Del. Ch. 2003) (holding that directors on a special litigation committee were not independent because other directors contributed substantial sums of money to a university with which the members of the special committee were affiliated); *In re Walt Disney Co. Derivative Litig.*, 906 A.2d 27 (Del. 2006) (analyzing a board's decision process to assess whether a \$130 million severance package paid to the president of a corporation upon his termination constituted a breach of fiduciary duty or waste).

⁷²See *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985); *Moran v. Household Int'l, Inc.*, 500 A.2d 1346 (Del. 1985); *Paramount Commc'ns, Inc. v. Time Inc.*, 571 A.2d 1140 (Del. 1989).

⁷³See *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985); *Moran v. Household Int'l, Inc.*, 500 A.2d 1346 (Del. 1985); *Paramount Commc'ns, Inc. v. Time Inc.*, 571 A.2d 1140 (Del. 1989). This contrasts with *Dodge* and *Shlensky*, where the input and motivations of the board (as distinguished from the controlling shareholder) were brushed aside as largely irrelevant.

⁷⁴*Paramount Commc'ns, Inc. v. Time Inc.*, 571 A.2d 1140 (Del. 1989).

actions of the board throughout the bidding and sale process, including creating a special committee of entirely outside directors and frequently meeting with management and outside experts.⁷⁵ This level of analysis of board activity would be alien to earlier courts, which lacked a distinct conception of board action.

In sum, the old board operated and was treated by courts as an arm of management.⁷⁶ Management felt little pressure and faced minimal accountability from the board, and shareholders enjoyed little effective representation.⁷⁷ While some evidence suggests this greater unity between management and the board allowed corporations to pursue a more stakeholder-friendly policy,⁷⁸ the lack of oversight also created the imperial CEO, with many negative consequences for society as well as shareholders.⁷⁹ The absence of oversight and accountability opened up the board of this era to attacks on its legitimacy.⁸⁰ Although the eventual shift in board composition addressed the lack of shareholder representation, its success in producing a more socially representative board (a goal beyond its remit) has been more limited.

B. 1970s to Today: The Independent Board

During the 1970s and 1980s, the board evolved away from its executive role and towards its current, more familiar status as a monitor.⁸¹ While the case for this shift was made as early as Douglas' article in the 1930s, high-profile corporate scandals in the 1970s generated additional impetus.⁸² These episodes highlighted the lack of meaningful oversight provided by the insider board.⁸³ For example, the implosion of Penn Central underscored the figurehead status of the traditional insider board,

⁷⁵*Id.* at 1143-44.

⁷⁶Gordon, *supra* note 31, at 1514.

⁷⁷*Id.* at 1516 ("The 'discipline' purportedly provided by the CEOs need to be accountable to his board peers was highly attenuated because 'managements [knew] from previous experience that members of the board will not ask penetrating, discerning, and challenging questions.")(quoting MYLES L. MACE, DIRECTORS: MYTH AND REALITY 180 (1971)).

⁷⁸*Id.* at 1511 ("For a 1950s firm, in addition to the profit-making objective, there were two other important elements: first, the impetus to balance among competing stakeholder objectives; second, the role of corporate management as a central planner.").

⁷⁹See MYLES L. MACE, DIRECTORS: MYTH AND REALITY 180 (1971); EISENBERG, *supra* note 9, at 170-202.

⁸⁰Gordon, *supra* note 31, at 1516.

⁸¹*Id.* at 1509.

⁸²*Id.* at 1518-20.

⁸³*Id.* at 1488, 1491, 1513-15.

characterized as it was by both a lack of independence and any incentive to challenge management.⁸⁴ The Watergate "questionable payments" abuses of securities laws tended to confirm the insider board's shortcomings in these regards.⁸⁵

These and other shocks of the 1970s were quickly followed by the hostile takeover boom of the 1980s. Stock price became the key consideration for corporate control. During this wave of aggressive deal-making, the independent monitoring board came to be seen as a tool for enhancing value, designed to ensure any hostile offer was considered by a board free of material conflicts.⁸⁶ Thus, an independent board acted as a signal to shareholders that opposition to a takeover bid was driven by the board's good faith belief that the offer was below the intrinsic value of the firm, not because insider directors feared the loss of employment and status that often accompanied a sale of the firm.⁸⁷ Investors began viewing these hostile bids as an expansive and messy solution to the managerial agency problem that had long been ignored by the board.⁸⁸ During this period, the preference for independent directors also became an important piece of Delaware law, with certain defensive devices to stave off hostile bids, such as the poison pill, receiving court approval when tied to informed decisionmaking by an independent board.⁸⁹ The clamor for an increase in board independence continued throughout the 1990s, as did the focus on shareholder value.⁹⁰ Additionally, the continued growth of institutional investors increased shareholder pressure on management to perform and reduced the autonomy enjoyed in the first half of the century.⁹¹

Today, the public company board, both practically and as a matter of stock exchange regulation, must be made up of a majority of

⁸⁴Gilson & Gordon, *supra* note 45, at 355; Gordon, *supra* note 31, at 1515–16.

⁸⁵Gordon, *supra* note 31, at 1516–17.

⁸⁶Joel Seligman, *A Sheep in Wolf's Clothing: The American Law Institute Principles of Corporate Governance Project*, 55 GEO. WASH. L. REV. 325, 328–40 (1987).

⁸⁷Gordon, *supra* note 31, at 1465, 1523.

⁸⁸Gordon, *supra* note 31, at 1465, 1528.

⁸⁹See *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946 (Del. 1985); *Moran v. Household Int'l, Inc.*, 500 A.2d 1346 (Del. 1985); *Paramount Commc'ns, Inc. v. Time Inc.*, 571 A.2d 1140 (Del. 1989); Gregory H. Shill, *The Independent Board as Shield*, 77 WASH. & LEE L. REV. 1811, 1872–79 (2020).

⁹⁰Notably, this shift towards shareholder wealth maximization diminished management's ability to consider other stakeholders. See Gordon, *supra* note 31, at 1529 ("A shareholder-oriented focus seemed part of the necessary restructuring of the American economy in a more competitive world.")

⁹¹Gordon, *supra* note 31, at 1521–22.

independent directors.⁹² Statutes and stock exchange rules require boards include a majority of independent directors⁹³ and that certain board committees consist solely of independent directors.⁹⁴ Though it does not require it, Delaware law has long offered material benefits to boards that shift to a majority-independent structure.⁹⁵ Some scholars have deemed the independent board to be an effective tool for shareholders in the face of defensive measures like the poison pill,⁹⁶ but paradoxically, the independent model also allows the board to function as a shield for managers, as well as directors themselves.⁹⁷ As *Caremark* oversight duties to mitigate risk multiply, for example in cybersecurity,⁹⁸ this function becomes more important. Current best practices call for the board to consist only or nearly only of independent directors, except for the CEO.⁹⁹

With the independent board takeover long since complete, two principal questions remain. The first concerns its efficacy as a monitor.¹⁰⁰ Current independence definitions and enforcement mechanisms leave a great deal to be desired, and leave mostly or completely unaddressed factors like in-group bias, self-interest, social perception, director tenure,

⁹²NYSE, Inc. Listed Company Manual § 303A.01 (2009).

⁹³15 U.S.C. § 78j-1(m)(3) (2012); NYSE, Inc., Listed Company Manual § 303A.01 (2009) ("Listed companies must have a majority of independent directors."); NASDAQ, Inc., Marketplace Rules § 5605(b)(1) (2006) ("A majority of the board of directors must be comprised of Independent Directors as defined in Rule 5605(a)(2).").

⁹⁴See Shill (2020), *supra* note 9, at 1826 (citing statutory and stock exchange mandates that three committees—audit, compensation, and nominating and governance—consist exclusively of independent directors).

⁹⁵Shill (2020), *supra* note 9, at 1818.

⁹⁶See Marcel Kahan & Edward B. Rock, *How I Learned to Stop Worrying and Love the Pill: Adaptive Responses to Takeover Law*, 69 U. CHI. L. REV. 871 (2002).

⁹⁷See generally Shill (2020), *supra* note 9, at 1811, 1829–36 (setting forth the relationship with state law); *Unocal Corp. v. Mesa Petroleum Co.*, 493 A.2d 946, 955 (Del. 1985) ("[S]uch proof [of showing good faith, which is a condition of business judgment rule protection] is materially enhanced. . . by the approval of a board comprised of a majority of outside independent directors . . .").

⁹⁸See, e.g., Benjamin P. Edwards, *Cybersecurity Oversight Liability*, 35 GA. ST. U. L. REV. 663, 665 (2019) ("Shareholder derivative litigation in the wake of a significant data breach or cybersecurity incident has now become a predictable risk for corporate directors."); Martin Edwards, *Expert Directors*, 90 U. COLO. L. REV. 1051, 1099 (2019) ("All major derivative actions against officers and directors for losses involved with data breaches have failed. . . Nonetheless, the risk of *Caremark* liability remains.") (*footnote omitted*).

⁹⁹NYSE, Inc. Listed Company manual § 303A.01

¹⁰⁰See Yaron Nili, *The Fallacy of Director Independence*, 2020 WISC. L. REV. 491 (2020); Shill (2020), *supra* note 9, at 1843–44; Shill (2017), *supra* note 9, at 1251; Lucian A. Bebchuk & Assaf Hamdani, *Independent Directors and Controlling Shareholders*, 165 U. PA. L. REV. 1271 (2017); Lisa M. Fairfax, *The Uneasy Case for the Inside Director*, 96 IOWA L. REV. 127, 158–59 (2010); Usha Rodrigues, *The Fetishization of Independence*, 33 J. CORP. L. 447, 462–63 (2008).

and other sources of potential cognitive bias that may undermine the board's mandate to prioritize shareholders.¹⁰¹ Second, the independent structure of the board does not speak to its composition or purpose.¹⁰² Goals of increasing diversity arguably relate to shareholder value, but may not do so in all cases.¹⁰³ Further, stakeholderism explicitly requires decentering shareholder value.¹⁰⁴ These shifts stand to destabilize the chummy relationships boards have had with managers during both the insider and independent board eras.¹⁰⁵

III. Directors and Managers: A Nonaggression Pact

Before being reborn as a body distinct from management, the board's formal supremacy¹⁰⁶ lacked practical effect. However, once the board became independent, the board's statutory grant of authority became operational—at least in theory.

The shift towards independence generated a byproduct: an implicit nonaggression pact between directors and managers. That understanding is under new pressure. Confident predictions about the pact's future are foolhardy, but the band of possible outcomes has widened compared with, say, a decade ago. Growing pluralism in board membership, structure, and corporate purpose suggests questions around latent board powers may become more urgent.

In addition to its general grant of authority, which can be traced to DGCL § 141, the board enjoys specific powers over certain decisions. In this Part, we categorize these powers as sounding in either the business strategy or governance of the firm (though of course they overlap). We then discuss powers reserved to shareholders. By describing these powers

¹⁰¹See Nili, *supra* note 100, at 503-05; Shill (2020), *supra* note 9, at 1845-46; Shill (2017), *supra* note 9, at 1289; Bebchuk & Hamdani, *supra* note 100, at 1274; Fairfax, *supra* note 100, at 147; Rodrigues, *supra* note 100, at 460.

¹⁰²Nili, *supra* note 100, at 512.

¹⁰³Fairfax, *supra* note 100, at 183-85.

¹⁰⁴See *infra* Part IV.A

¹⁰⁵Gilson & Gordon, *supra* note 45, at 355.

¹⁰⁶See DEL. CODE ANN. tit. 8, § 141(a) (2019) (providing that "[t]he business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors"); *In re WeWork Litig.*, 250 A.3d 901, 910 (Del. Ch. Aug. 21, 2020) ("It is a 'cardinal precept' of Delaware law that the business and affairs of a corporation ... shall be managed by or under the direction of a board of directors." (internal quotation marks and citations omitted)).

at length, we do not take a normative view on either their allocation between the board and shareholders nor any related questions of law, such as whether stakeholders not represented in either group should enjoy more power. Our analysis suggests that while many public company boards commonly act subordinately to managers, the statutory, regulatory, and contractual creature that is the board is a sleeping giant that, if reconfigured in accordance with any number of reform visions, has the ability to break free of the soft constraints that currently bind it to managers. At scale, this combination has the potential to effectuate major changes in corporate law, markets, and indeed capitalism.

A. *The Board's Power Over Business Strategy*

The board determines all corporate policy questions for the firm. Such policies range from business strategy to human resources to capital structure.¹⁰⁷ Where not delegated to managers, this work may be outsourced to third-party service providers,¹⁰⁸ but the board directs it. This is arguably the most important power of the board.

The exercise of this power is protected from attack by Delaware law.¹⁰⁹ The default standard of review for board decisions is the business judgment rule.¹¹⁰ This rule creates a presumption that directors are making their decisions in good faith.¹¹¹ It is contingent on the director's satisfaction of the duty of care (making decisions on an informed basis and after ample consideration) and loyalty (placing the corporation's interest ahead of her own).¹¹² The burden of showing a breach of those duties is on the shareholder-plaintiff.¹¹³ The rule insulates directors for unwise or even negligent decisions; rather, something closer to gross negligence must be shown before liability attaches.¹¹⁴ Although technically a standard of review, the business judgment rule also has properties of an abstention doctrine since it creates an expansive universe of board decisions the

¹⁰⁷ See Lucian A. Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833, 844-47 (2005) (distinguishing between "rules of the game decisions" and "specific business decisions").

¹⁰⁸*Id.*

¹⁰⁹*Frederick Hsu Living Tr. v. ODN Holding Corp.*, C.A. No. 12108-VCL, 2017 WL 1437308, at *25 (Del. Ch. Apr. 14, 2017), *as corrected* (Apr. 24, 2017).

¹¹⁰*Id.* at *25.

¹¹¹*Id.*

¹¹²*Id.* at 26.

¹¹³*Frederick Hsu Living Tr.*, 2017 WL 1437308 at *26.

¹¹⁴Gordon, *supra* note 31, at 1485.

merits of which judges do not pass upon.¹¹⁵ One motivation for this carve-out has been described as comparative advantage—the board has superior expertise and information about the business relative to the court—which corresponds intuitively to the duty of care.¹¹⁶ That concept is also extended to the duty of loyalty.¹¹⁷ This is a less natural fit, given that courts regularly assess the types of conflicts of interest that are at the heart of that duty, but it remains available as a shield all the same.

Capital decisions are likewise vested in the board.¹¹⁸ For example, exclusive authority to declare and pay dividends resides with the board.¹¹⁹ Notwithstanding the holding of *Dodge*,¹²⁰ modern courts do not closely scrutinize. Delaware courts have repeatedly emphasized that the decision about whether to declare such payments is a quintessential business judgment that will not be disturbed absent "fraud or gross abuse of discretion."¹²¹ Thus, the board retains nearly complete control over whether the retained earnings of the firm are reinvested in the corporation or returned to shareholders as dividends. Similarly, it is squarely within the board's business judgment to repurchase or redeem the corporation's stock.¹²²

¹¹⁵*Kallick v. Sandridge Energy, Inc.*, 68 A.3d 242, 257 (Del. Ch. 2013) ("For their part, the incumbent board argues that the standard of review is the plain vanilla business judgment rule, which requires that their decision be approved if it can be attributed to any rational business purpose. Thus, the incumbent board argues for something as close to non-review as our law contemplates."); *see also* *Brehm v. Eisner*, 746 A.2d 244, 264 (Del. 2000) ("Irrationality is the outer limit of the business judgment rule. Irrationality may be the functional equivalent of a waste test or tend to show that the decision is not made in good faith, which is a key ingredient of the business judgment rule." (footnote omitted)).

¹¹⁶*Shill* (2020), *supra* note 9, at 1889-90.

¹¹⁷For a discussion of this tension and a proposed solution to it, *see* *Shill* (2020), *supra* note 9 at 1895-1902 (proposing that board decisions implicating the duty of loyalty be subject to review for entire fairness, the least deferential standard in corporate law, rather than business judgment).

¹¹⁸DEL. CODE ANN. tit. 8 § 170(a) (2019).

¹¹⁹DEL. CODE ANN. tit. 8 § 170 (2019) (providing that such payments can be made "out of [the corporation's] surplus" or "out of its net profits for the fiscal year in which the dividend is declared and/or the preceding fiscal year.").

¹²⁰*Dodge v. Ford Motor Co.*, 240 Mich. 459, 493 (1919).

¹²¹*Moskowitz v. Bantrell*, 41 Del. Ch. 177, 179, 190 A.2d 749, 750 (1963). Courts in other jurisdictions have also, more famously, followed this general principle. *See* *Kamin v. Am. Exp. Co.*, 86 Misc. 2d 809, 812, 383 N.Y.S.2d 807, 810 (Sup. Ct.), *aff'd sub nom.* *Kamin v. Am. Express Co.*, 54 A.D.2d 654, 387 N.Y.S.2d 993 (1976) ("More specifically, the question of whether or not a dividend is to be declared or a distribution of some kind should be made is exclusively a matter of business judgment for the Board of Directors.").

¹²²Lenore Palladino, *Examining Corporate Priorities: The Impact of Stock Buybacks on Workers, Communities and Investors*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Oct. 22, 2019), <https://corpgov.law.harvard.edu/2019/10/22/examining-corporate-priorities-the-impact-of-stock-buybacks-on-workers-communities-and-investors/> ("As long as directors are using their

The board is also responsible for selecting managers of the firm, including hiring and firing the CEO.¹²³ Though subject to final approval by shareholders, the board can also initiate a dissolution and winding up of the corporation.¹²⁴

In sum, the board makes policy, strategy, capital, and key personnel decisions for the firm with near-total discretion,¹²⁵ and can set the "kill switch" of dissolution in motion. Boards often devolve or outsource discretion in practice,¹²⁶ but legally, the corporation is dominated by the board.

B. *The Board's Governance Powers*

In addition to steering the corporate ship, the board is in the unique position of determining its own rules of the game. It chooses, for starters, the rights that come with ownership of shares, the jurisdiction whose laws govern the firm's internal affairs, and (usually) the identity of those who oversee it.

1. Share Structure

Increasingly, U.S. firms—especially technology companies—use a dual-class share structure.¹²⁷ This model typically provides one class of common stock for public shareholders and another for insiders, who are normally founders and early investors, such as venture capital firms.¹²⁸ It allows management a chance to maintain control of the firm notwithstanding the issuance of public equity, even if most of the firm's

best 'business judgment' to authorize programs, and there is no other insider trading violations, there is no recourse to hold directors accountable for extremely high repurchase programs. ").

¹²³DEL. CODE ANN. tit. 8 § 142(b) (2019) ("Officers shall be chosen in such manner and shall hold their offices for such terms as are prescribed by the bylaws or determined by the board of directors or other governing body. ").

¹²⁴DEL. CODE ANN. tit. 8 § 275(a) (2019); Jay B. Kesten, *Shareholder Political Primacy*, 10 VA. L. & BUS. REV. 161, 230 n.343 (2016); Part II.B, *infra*.

¹²⁵Subject, of course, to generally applicable laws, such as those regulating labor and the environment.

¹²⁶Boards can even outsource core functions to third-party service providers. For a book-length treatment of this phenomenon and its potential and drawbacks, see M. TODD HENDERSON & STEPHEN M. BAINBRIDGE, *OUTSOURCING THE BOARD* (2018).

¹²⁷See, e.g., Elizabeth Pollman, *Startup Governance*, 168 U. PA. L. REV. 155 (2019).

¹²⁸Claudia H. Allen, *Bylaws Mandating Arbitration of Stockholder Disputes?*, 39 Del. J. Corp. L. 751, 793 (2015) ("Companies that are going public often include provisions, such as classified boards and dual class common stock, which are not 'stockholder friendly,' in their organizational documents. ").

equity is sold to other shareholders.¹²⁹ These unequal share structures are commonly found at many of the nation's largest, most profitable, and socially and politically influential firms.

Dual-class share structures are typically adopted prior to or at the stage of the initial public offering ("IPO"). Thus, the discretion to establish a share structure rests with the pre-IPO board and is functionally beyond the reach of shareholders, despite its impact on shareholder voice¹³⁰ and the value of the corporation as a whole.¹³¹ Specifically, dual-class structures, which effectively separate voting and equity interests in the corporation,¹³² are linked to reduced shareholder involvement and weaker ownership incentives.¹³³ Further, in public corporations where founders and early investors retain voting control but sacrifice a significant equity stake through an IPO, the lack of market discipline inherent in controlled corporations is linked to a reduction in overall firm value,¹³⁴ especially as the benefits of dual class structures dissipate over time in the now-public firm.¹³⁵ Of course, there are merits to the dual-class structure as well—for example, Dorothy Lund has argued that it makes corporate governance more efficient by creating a class of investment that affords economic

¹²⁹See Lucian A. Bebchuk & Kobi Kastiel, *The Untenable Case for Perpetual Dual-Class Stock*, 103 VIRGINIA L. REV. 585, 607 (2017).

¹³⁰*Id.*

¹³¹*Id.* at 630.

¹³²See, e.g., Dave Michaels, *Facebook, Snap and Other Firms Targeted by SEC Regulator's Attack on Dual-Class Shares*, WALL ST. J. (Feb. 15, 2018), <https://www.wsj.com/articles/facebook-to-viacom-targeted-by-sec-regulators-attack-on-dual-class-shares-1518730229>; CNBC, *Airbnb's S-1-IPO Filing Drops* (November 16, 2020) <https://www.cnbc.com/2020/11/16/airbnb-s-1-ipo-filing-drops.html>.

¹³³Lucian A. Bebchuk & Kobi Kastiel, *The Perils of Small-Minority Controllers*, 107 GEO. L.J. 1453, 1466 (2019) (observing that "small-minority controllers are insulated from market disciplinary forces [in dual-class companies] and thus lack incentives generated by the threat of replacement, which would mitigate the risk that they will act in ways that are contrary to the interests of other public investors"); *id.* ("[D]ualclass structures with small-minority controllers generate significant governance risks because they feature a unique absence of incentive alignment."); David T. White, *Delaware's Role in Handling the Rise of Dual-, Multi-, and Zero-Class Voting Structures*, 45 Del. J. Corp. L. 141, 154 (2020) ("Therefore, the protections that the marketplace provides to minority owners in 'one share-one vote' companies are nonexistent in these dual-class structures.").

¹³⁴Kosmas Papadopoulos, *Dual-Class Shares: Governance Risks and Company Performance*, HARV. L. SCH. F. ON CORP. GOVERNANCE (June 28, 2019), <https://corpgov.law.harvard.edu/2019/06/28/dual-class-shares-governance-risks-and-company-performance>

¹³⁵*Id.*; see also Lucian A. Bebchuk & Kobi Kastiel, *The Untenable Case for Perpetual Dual-Class Stock*, 103 Va. L. Rev. 585, 603 (2017) ("[T]he empirical evidence indicates that the combination of entrenchment and low equity holdings reduces firm value and generates significant agency costs.").

exposure without an obligation to engage in informed voting¹³⁶—and an empirical and normative literature around its use is blossoming. Crucially, the decision of whether to adopt the structure in the first place is left to board discretion.

There are scarcely any effective legal limitations on the use of these structures.¹³⁷ Much of the research has been in the context of founder-led controlled firms.¹³⁸ For example, Facebook founder and CEO Mark Zuckerberg owns under 30 percent of the corporation's equity, but controls a majority of its voting power.¹³⁹ The same holds true for the parent company of Google and its co-founders Larry Page and Sergei Brin, who together control a majority of the firm's votes despite owning only a single-digit percentage of its equity.¹⁴⁰ Lyft¹⁴¹ and Tesla supply additional examples.¹⁴² Snap's situation is perhaps the most unequal of all: its public shareholders do not enjoy any voting rights at all. Since it went public in 2017, several other companies have done with a similar structure.¹⁴³

Whatever its merits and demerits in the context of the current corporate board, the ability to establish classes of shares with different (or zero) voting rights in a world of corporate pluralism would take on new significance. For instance, a board could choose to award additional voting rights to certain constituencies (pension funds perhaps). Or, it could deny

¹³⁶Dorothy S. Lund, *Nonvoting Shares and Efficient Corporate Governance*, 71 STAN. L. REV. 687 (2019).

¹³⁷See Lucian Bebchuk & Kobi Kastiel, *The Perils of Small-Minority Controllers*, 107 GEORGETOWN L.J. 1453, 1466-68 (2017).

¹³⁸*Id.* at 1453.

¹³⁹See Facebook, DEF 14A Proxy Statement (2020).

¹⁴⁰See Alphabet, DEF 14A Proxy Statement (2020).

¹⁴¹Post-IPO, the co-founders of Lyft owned under five percent of the company, but they retained a near majority of the voting power. Lucian Bebchuk & Kobi Kastiel, *The Perils of Lyft's Dual-Class Structure*, HARV. L. SCH. F. ON CORP. GOVERNANCE AND FIN. REG., Apr. 3, 2019, <https://corpgov.law.harvard.edu/2019/04/03/the-perils-of-lyfts-dual-class-structure/>.

¹⁴²Elon Musk owns only about 20 percent of Tesla, but the company's charter grants him a de facto veto over governance matters. See Tesla Schedule 14A (2020); Tim Higgins, *Tesla Board Fails to Pass Supermajority Measure It Proposed Amid Call for More Oversight*, WALL ST. J. (June 12, 2019), <https://www.wsj.com/articles/tesla-shareholders-rejectmeasure-to-eliminate-super-majority-vote-requirement-11560290775>. Litigation claiming he controlled the corporation during its 2016 acquisition of SolarCity is ongoing. See Rebecca Elliott & Dave Michaels, *Elon Musk Is Called to Defend Tesla's Purchase of SolarCity*, WALL ST. J. (July 11, 2021), <https://www.wsj.com/articles/elon-musk-is-called-to-defend-teslas-purchase-of-solarcity-11626001200>.

¹⁴³The trend of issuing non-voting shares may be on the upswing; in 2018, one company followed Snap's model, while in 2019 three did and in 2020 five did. See Council of Institutional Investors, *Dual-Class IPO Snapshot: 2017-2020 Statistics*, <https://www.cii.org/files/2020%20IPO%20Update%20Graphs%20.pdf>.

them to passive institutional investors.¹⁴⁴ Alternatively, it could offer them an additional equity stake but no votes. The board would be limited primarily by market discipline and their own imagination.

2. Governing Law for Internal Affairs

In the first instance, the incorporators of a firm choose the jurisdiction of incorporation.¹⁴⁵ In Delaware, as well as in jurisdictions that have adopted the Model Business Corporation Act (about half the states),¹⁴⁶ the power to initiate reincorporation in a different jurisdiction is vested in the board, but subject ultimately to shareholder approval.¹⁴⁷ The power to convert to a different entity, for example a LLC, similarly belongs to the board.¹⁴⁸

By selecting the state of incorporation, boards choose the law under which they may be held to account. The jurisdiction of incorporation is the single most important factor determining shareholder rights. Aside from certain provisions of the federal securities laws—mostly having to do with fraud—the state of incorporation is the source of law that grants shareholders rights qua shareholders. In the absence of a forum selection or choice of law clause to the contrary,¹⁴⁹ the internal affairs doctrine

¹⁴⁴Dorothy S. Lund, *The Case Against Passive Shareholder Voting*, 43 J. CORP. L. 493 (2017) (proposing that legislatures restrict passive investment funds from voting in shareholder meetings).

¹⁴⁵Lynn M. LoPucki, *Corporate Charter Competition*, 102 MINN. L. REV. 2101, 2116 (2018) ("Managers, not shareholders, choose the incorporation state. In an initial public offering, corporate insiders make the choice before they approach the underwriters. The underwriters present the managers' choice to the prospective shareholders as a take-it-or-leave-it proposition."); William J. Carney, et al., *Lawyers, Ignorance, and the Dominance of Delaware Corporate Law*, 2 HARV. BUS. L. REV. 123, 139 (2012) ("In contrast, by the time the underwriter's lawyer became involved, 81% of the companies had already incorporated in the state that would be used for the IPO.").

¹⁴⁶See Stephen M. Bainbridge, *A Map of Model Business Corporation Act States*, PROFESSORBAINBRIDGE.COM (Nov. 4, 2013), <https://www.professorbainbridge.com/professorbainbridgecom/2013/11/a-map-of-model-business-corporation-act-states.html>.

¹⁴⁷See DEL. CODE ANN. tit. 8 § 266(b) (2019) (setting forth a reincorporation procedure for Delaware corporations whereby the board must vote to convert to a non-Delaware corporation and then such proposed conversion must be approved by shareholders); MBCA § 9.20.

¹⁴⁸See DEL. CODE ANN. tit. 6 §18-214; MBCA § 9.30.

¹⁴⁹The permissible terms of these and their process of adoption has been a subject of several prominent litigations in recent years, part of a larger category of lawsuits contesting efforts by boards to determine ex ante the scope, terms, and forum of shareholder disputes. See, e.g., Ann M. Lipton, *Manufactured Consent: The Problem of Arbitration Clauses in Corporate Charters and Bylaws*, 104 GEO. L.J. 583 (2016); Ann M. Lipton, *Limiting Litigation Through*

provides that the state of incorporation is also the only state where shareholders may bring suit against the corporation.¹⁵⁰ The law of the state of incorporation also controls in these actions, known as derivative suits. Boards choose from packages of rules and courts in the market for internal affairs law.¹⁵¹

State laws concerning shareholder rights and fiduciary duties exhibit material variation, with antitakeover statutes providing a key example.¹⁵² Guhan Subramanian found that Delaware and Nevada, two of the most common states of incorporation, differ significantly in their approach to these statutes.¹⁵³ Between 1987 and 1991, Nevada passed five antitakeover statutes—namely what Subramanian defined as constituency statutes, control share acquisition statutes, business combination statutes, and pill validation statutes.¹⁵⁴ On the contrary, Delaware passed only one, a business combination statute, in 1987.¹⁵⁵ Similarly, Delaware and New York law—both of which are often expressly designated as the governing law in large complex transaction documents—have different statutes of limitation for breach of contract claims and have distinctly different approaches to issues related to sandbagging and "best efforts" covenants.¹⁵⁶ Beyond statutory law, states also differ in their caselaw and the experience, sophistication, and pace of their court systems. Delaware is commonly cited as having an overall advantage in this latter category.

State advantages can, however, be specific to entity type. Maryland has established itself as a preferred state of incorporation for real estate investment trusts ("REITs").¹⁵⁷ One theory is that the state "affords REITs relatively broad protection from liability," has a "developed body of law

Corporate Governance Documents, HARV. L. SCH. F. ON CORP. GOVERNANCE (Dec. 12, 2016), <https://corpgov.law.harvard.edu/2016/12/12/limiting-litigation-through-corporate-governance-documents>

¹⁵⁰*VantagePoint Venture Partners 1996 v. Examen, Inc.*, 871 A.2d 1108, 1112 (Del. 2005) ("The internal affairs doctrine is a long-standing choice of law principle which recognizes that only one state should have the authority to regulate a corporation's internal affairs—the state of incorporation."); *see also* *Edgar v. MITE Corp.*, 457 U.S. 624, 645 (1982).

¹⁵¹*See* ERIN A. O'HARA & LARRY RIBSTEIN, *THE LAW MARKET* (2009).

¹⁵²Guhan Subramanian, *The Influence of Antitakeover Statutes on Incorporation Choice: Evidence on the "Race" Debate and Antitakeover Overreaching*, 150 U. PA. L. REV. 1795, 1848 (2002).

¹⁵³*Id.* at 1856.

¹⁵⁴*Id.* at 1828.

¹⁵⁵*Id.*

¹⁵⁶Daniel Wolf, *Delaware v. New York Governing Law*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Jan. 2, 2014), <https://corpgov.law.harvard.edu/2014/01/02/delaware-vs-new-york-governing-law>.

¹⁵⁷Erika Morphy, *Why US REITs Flock to Maryland*, GLOBE STREET (Apr. 9, 2014), <https://www.globest.com/sites/globest/2014/04/09/why-us-reits-flock-to-maryland>.

that makes it relatively difficult to remove a REIT's trustees from office," and "affords REITs stronger protection against hostile takeovers."¹⁵⁸ As with Delaware and corporations, there are also likely network advantages to the use of Maryland code for REITs; it is easier to attract investors to a known quantity that contains market-standard terms and differs from its peers for business reasons (e.g., the quality of its managers) rather than legal ones.¹⁵⁹ A substantial literature documents this pattern and its downsides in sophisticated commercial contracts.¹⁶⁰

Some evidence suggests that jurisdictional choice is associated with changes in firm value.¹⁶¹ We take no position in the normative or empirical debates in the corporate law literature over whether the internal affairs doctrine results in a race to the bottom or a race to the top,¹⁶² except to underscore the materiality of the power to choose a jurisdiction of incorporation (and thus its body of law, courts, and regulators).

3. Determination of Independent Director Status

Stock exchange rules require that public-company boards contain a majority of independent directors.¹⁶³ In addition, exchange rules adopted following the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley") and the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010

¹⁵⁸*Id.*

¹⁵⁹*Id.*

¹⁶⁰*See, e.g.,* MITU GULATI & ROBERT E. SCOTT, *THE THREE AND A HALF MINUTE TRANSACTION BOILERPLATE AND THE LIMITS OF CONTRACT DESIGN* (2012); Gregory H. Shill, *Boilerplate Shock: Sovereign Debt Contracts as Incubators of Systemic Risk*, 89 *TULANE L. R.* 751 (2015).

¹⁶¹*See* Robert Daines, *Does Delaware Law Improve Firm Value?*, 62 *J. FIN. ECON.* 525 (2001) ("Using Tobin's Q as an approximation of firm value, I find that Delaware firms are worth more than similar non-Delaware firms in a sample of 4,481 exchange-traded U.S. corporations between 1981-1996.").

¹⁶²The gist of the controversy is whether the internal affairs doctrine enhances efficiency through jurisdictional competition or instead serves management interests via a race to the bottom. *See, e.g.,* Subramanian, *supra* note 152, at 1848; Anne Anderson, Jill Brown & Parveen Gupta, *How State Competition for Corporate Charters Has Changed the Delaware Effect*, *CLS BLUE SKY BLOG* (Oct. 16, 2017), <https://clsbluesky.law.columbia.edu/2017/10/16/how-state-competition-for-corporate-charters-has-changed-the-delaware-effect> (finding that Delaware-incorporated firms have less debt and higher value as measured by Tobin's Q than firms incorporated in other jurisdictions, supporting a "race to the top" conclusion).

¹⁶³*See* NYSE, *Listed Company Manual* § 303A.01 (2009) ("Listed companies must have a majority of independent directors."); NASDAQ, *Marketplace Rules* § 5605(b)(1) (2006), ("A majority of the board of directors must be comprised of Independent Directors as defined in Rule 5605(a)(2)."); Shill (2020), *supra* note 9, at 1838-43 (detailing stock exchange rules).

("Dodd-Frank") require that audit¹⁶⁴ and compensation¹⁶⁵ committees, respectively, consist solely of independent directors. However, this requirement is general and has not been enforced vigorously by stock exchanges, thus allowing boards to self-certify their independence with little fear of investigation or discipline.¹⁶⁶ This lack of enforcement is particularly notable in light of the fact that stock exchange rules do not provide for a private right of action.¹⁶⁷ Thus, in most instances, the board's self-designation is final.¹⁶⁸ In addition, disclosure requirements regarding boards' independence determinations are minimal.¹⁶⁹ This lack of transparency inhibits market discipline on the question.

4. § 102(b)(7) Exculpation of Liability for the Duty of Care

Another key feature of modern corporate governance is the power of boards to self-insulate. Section 102(b)(7) of the DGCL provides that corporations may include provisions of the certificate of incorporation that "eliminat[e] or limit[] the personal liability of a director" for breaching the fiduciary duty of care.¹⁷⁰ These so-called exculpation clauses, now in

¹⁶⁴See 17 C.F.R. § 240.10A-3(b); Shill (2020), *supra* note 9, 1836–38 (detailing federal law mandates). The mandate is implemented at the stock exchange level by N.Y. Stock Exch., Listed Companies Manual § 303A.07 (2016); NASDAQ Stock Mkt., Equity Rules § 5605(c)(2)(A) (2016).

¹⁶⁵Dodd-Frank Act § 952; 17 C.F.R. § 240.10C-1; Shill (2020), *supra* note 9 at 1836–38 (detailing federal law mandates).

¹⁶⁶See Yaron Nili, *Out of Sight, Out of Mind: The Case for Improving Director Independence Disclosure*, 43 J. CORP. L. 35, 63 (2017) ("in the context of the stock exchange listing rules, the designation of directors as independent is designed to be difficult to enforce, and in practice is rarely enforced"); Shill (2020), *supra* note 9, at 1838–43 (detailing stock exchange rules) (2020); see also Timothy J. Johnston, *Is Mandatory Real-Time Disclosure Really Mandatory? A Comparison of Real-Time Disclosure Frameworks and Enforcement*, 47 SEC. REGUL. L. J. 44 (2019).

¹⁶⁷NASDAQ OMX Grp, Inc. v. UBS, Sec, LLC, 770 F.3d 1010, 1046 (2d. Cir. 2014) (Straub, J., dissenting) ("It is undisputed that the Exchange Act does not provide for a private cause of action for violations of stock exchange rules.").

¹⁶⁸See Shill (2020), *supra* note 9, at 1853–56 (discussing problems with board designations of director independence); Nili, *supra* note 166, at 70–74 (proposing a disclosure-based remedy to that problem).

¹⁶⁹Nili, *supra* note 166, at 38; RR Donnelley et al., *2015 Investor Survey: Deconstructing Proxy Statements--What Matters to Investors*, STAN. BUS. (2015), <https://www.gsb.stanford.edu/faculty-research/publications/2015-investor-survey-deconstructing-proxy-statements-what-matters> (finding that 60 percent of institutional investors view company independence disclosures as somewhat or not at all effective).

¹⁷⁰DEL. CODE ANN. tit. 8 § 102(b)(7).

public companies, are typically added at formation by the incorporators (later board members) or by the board after incorporation.¹⁷¹

5. Indemnification, Directors & Officers Insurance, and Proxy Campaigns

Over and above § 102(b)(7) exculpation clauses, DGCL § 145 also allows the corporation to protect directors and officers from personal liability, either by indemnifying them or by purchasing insurance to cover any damage award against them.¹⁷² Where indemnification of directors is permissive, the decision whether to do so is left to the board and receives business judgment deference.¹⁷³ Through indemnification, boards typically assign to the corporation the financial burden—both the use of in-house counsel and the hiring of outside counsel—to defend board members from shareholder lawsuits.¹⁷⁴

Subsection (g) of § 145 also allows the corporation to purchase director and officer insurance.¹⁷⁵ The decision whether to purchase this coverage is a business judgment of the board.¹⁷⁶ Insurance practice and some case law may contain some exclusions for fraud or intentional misconduct,¹⁷⁷ but the power to use corporate funds to buy insurance for the board lies with its directors.

In addition, the board may authorize the corporation to pay legal, advertising, and other fees associated with defending incumbent board members from proxy campaigns.¹⁷⁸ This provides incumbent board members with an important advantage in proxy fights, which often cost

¹⁷¹*Id.* If added after formation, shareholder approval is required.

¹⁷²DEL. CODE ANN. tit. 8 § 145 (1953).

¹⁷³DEL. CODE ANN. tit. 8 § 145(c) (1953). In addition, where a director or officer is "successful on the merits or otherwise in defense of any action, suit or proceeding," the corporation must indemnify her; Donald E. Pease, *Outside Directors: Their Importance to the Corporation and Protection from Liability*, 12 DEL. J. CORP. L. 25, 72 (1987) ("First, with respect to either type of action, if the director is 'successful on the merits or otherwise in defense of any action, suit or proceeding,' section 145(c) requires the corporation to indemnify him.").

¹⁷⁴Pease, *supra* note 173, at 72-73.

¹⁷⁵DEL. CODE ANN. tit. 8 § 145(g) ("A corporation shall have power to purchase and maintain insurance on behalf of any person who is or was a director, officer, employee or agent of the corporation . . .").

¹⁷⁶DEL. CODE ANN. tit. 8 § 145; E. Norman Veasey et al., *Delaware Supports Directors with a Three-Legged Stool of Limited Liability, Indemnification, and Insurance*, 42 BUS. LAW. 399, 404 (1987).

¹⁷⁷Pease, *supra* note 173, at 82.

¹⁷⁸*See* Levin v. Metro-Goldwyn-Mayer, Inc., 264 F. Supp. 797 (S.D.N.Y. 1967) (applying Delaware law).

millions of dollars and threaten their board positions (part-time jobs that pay over \$1,000 an hour at the median¹⁷⁹).

6. Board Committees, Meetings, and Policies

So long as they act consistently with the statutory and regulatory minima discussed above, boards enjoy wide discretion in determining whether to set up new committees and, if so, how to constitute them. "A director's right to information is 'essentially unfettered in nature,'"¹⁸⁰ but boards can create barriers to the flow of that information to certain directors. For example, boards that have been the focus of hedge fund activism campaigns frequently settle with the fund. As part of that settlement, they often agree to seat a director designated by the fund. Without outright refusing to share information, the incumbent board members can keep their activist colleague off of certain committees or constitute a special committee to make decisions about a particular transaction and exclude her from it.¹⁸¹

Boards and committees may elect to hold their meetings in person, by video, or telephone so long as "all persons participating in the meeting can hear each other."¹⁸² While perhaps more convenient or necessary during the COVID-19 pandemic, such a structure also makes it easier for a board or committee chair to control the proceedings, raising concerns not dissimilar to those around virtual shareholder meetings, discussed *infra*.

¹⁷⁹Shill (2017), *supra* note 9, at 1267 (\$255,000 median annual salary for a self-reported five hours a week of work). Average public-company director compensation is even higher than the median. See Matthew Friedstedt et al., *Trends in U.S. Director Compensation*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Aug. 16, 2020), <https://corpgov.law.harvard.edu/2020/08/16/trends-in-u-s-director-compensation/> (reporting average compensation for S&P 500 outside directors during the proxy year ending in 2019 as \$304,856, as calculated by the executive compensation consultancy Spencer Stuart).

¹⁸⁰*Kalisman v. Friedman*, No. CIV.A. 8447-VCL, 2013 WL 1668205, at *3 (Del. Ch. Apr. 17, 2013) (quoting *Schoon v. Troy Corp.*, No. 1677-N, 2006 WL 1851481, at *1 n.8 (Del. Ch. June 27, 2006)).

¹⁸¹*Kalisman* included facts similar to these, arguably more egregious in that the corporation asserted attorney-client privilege in an attempt to withhold information from the designated director. *Id.* at *4-5. While the outcome in that case was favorable for the designated director, less extreme cases might still be permissible. See *Id.* at *4-7 (describing situations where a director's access to information may be lawfully diminished). One common example is an *ex ante* agreement to restrict both access to and sharing of information by a designated director. See *Id.* at *4; Shill (2017), *supra* note 9, 1286-89.

¹⁸²DEL. CODE ANN. tit. § 141(i).

On the other hand, the virtual structure also makes it easier for boards to engage retail shareholders and diffuse stakeholder constituencies.¹⁸³

Boards also enjoy broad discretion to establish policies or other "shadow governance" documents.¹⁸⁴ In principle, these are primarily procedural devices to do with internal board operations, but like any rule of organization, they can be used to advance substantive ends.

7. Charitable and Political Donations

The board enjoys significant power to allocate money from the corporate purse for purposes that are substantially personal in nature. One example is charitable contributions. Through the board, directors may authorize donations to charities.¹⁸⁵ They may also authorize contributions to political causes, such as political action committees, parties, or candidates of their choosing.¹⁸⁶ These decisions are subject to directors' state-law fiduciary duties of care and loyalty, and must not constitute waste, but this is a notably high bar for plaintiffs.¹⁸⁷

¹⁸³See, e.g., Yaron Nili & Megan Shaner, *Virtual Annual Meetings: A Path Toward Shareholder Democracy and Stakeholder Engagement*, 63 B.C. L. REV. 125 (2022).

¹⁸⁴See Cathy Hwang & Yaron Nili, *Shadow Governance*, 108 CAL. L. REV. 1097 (2020).

¹⁸⁵See, e.g., *A.P. Smith Mfg. Co. v. Barlow*, 98 A.2d 581 (N.J. 1953).

¹⁸⁶See *Citizens United v. FEC*, 558 U.S. 310 (2010) (holding the participation of corporations in the political process has been deemed worthy of constitutional protection).

¹⁸⁷See Shill (2020), *supra* note 9, at 1862–72. See e.g., *Khan v. Sullivan*, 594 A.2d 48, 61 (Del. 1991) (upholding a determination that a corporation's charitable donation to a museum that would house the late CEO's art collection would, given approval by the board, enjoy business judgment protection and not constitute waste). For an in-depth discussion of director fiduciary duties in relation to self-dealing, see Andrew F. Tuch, *Reassessing Self-Dealing: Between No Conflict and Fairness*, 88 FORDHAM L. REV. 939 (2019).

8. Shareholder Meeting Formats

Subject to certain minima,¹⁸⁸ Delaware law grants the board of directors "sole discretion" over the form of shareholder meetings.¹⁸⁹ Until recently, in-person and hybrid meeting formats¹⁹⁰ have predominated.¹⁹¹ However, Delaware law also allows corporations to hold virtual-only meetings, where no physical meeting of shareholders and management takes place.¹⁹² The use of virtual shareholder meetings has grown slowly over the past few years, with the share of corporations in the Russell 3000 using that format increasing from 2.4% in 2014 to 7.9% in 2019.¹⁹³ In 2020, due to the COVID-19 pandemic, this figure shot up to 73.5%.¹⁹⁴ The future of meeting formats post-pandemic is not yet clear.

Pre-pandemic, virtual meetings had long been criticized by scholars and proxy advisors for their perceived chilling effects on shareholder rights and corporate transparency.¹⁹⁵ The gist of the concerns is that

¹⁸⁸Regardless of form, shareholder meetings of Delaware corporations must ensure that only shareholders attend the meeting, shareholders can participate in the meeting and vote on matters, and any vote is properly recorded and maintained by the corporation. DEL. CODE ANN. tit 8 § 211 (2019).

¹⁸⁹*Id.* See Joseph McLean, "Sole Discretion" Is Too Much Discretion: An Analysis of Delaware's Online Shareholder Meeting Statutory Model, KAN. J.L. & PUB. POL'Y, 218 (2013-2014) (arguing that shareholders should determine the venue of the meeting).

¹⁹⁰McLean, *supra* note 189, at 203. Hybrid meetings allow shareholder to either attend a physical meeting or virtually "call in" to vote and ask questions.

¹⁹¹Shareholder Engagement is Increasing via Technology, Broadridge Hosts its 1,000th Virtual Shareholder Meeting, BROADRIDGE (Jul. 9, 2018), <https://www.broadridge.com/press-release/2018/broadridge-hosts-its-1000th-virtual-shareholder-meeting>

¹⁹²DEL. CODE ANN. tit. 8 § 211 (2019); Lisa M. Fairfax, *Virtual Shareholder Meetings Reconsidered*, 40 SETON HALL L. REV. 1367, 1372 (2010) ("Delaware's use of the phrase 'sole discretion' was deliberate and meant to ensure that the decision regarding whether to host an electronic shareholder meeting rested completely in the hands of directors.") (citing Jesse A. Finkelstein, *Shareholder Meetings in Cyberspace: Will Your Next Meeting Location Be a Web Site?*, INSIGHTS: CORP. & SEC. L. ADVISOR, June 2000, at 14).

¹⁹³Matteo Tonello, *2021 Proxy Season Preview and Shareholder Voting Trends (2017-2020)*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Feb. 11, 2021), <https://corpgov.law.harvard.edu/2021/02/11/2021-proxy-season-preview-and-shareholder-voting-trends-2017-2020>.

¹⁹⁴*Id.*

¹⁹⁵Lisa M. Fairfax, *Virtual Meetings Reconsidered*, 40 SETON HALL L. REV. 1367, 1392-94 (2010) (providing a detailed account of the advantages and disadvantages of online shareholder meetings); Joseph McLean, "Sole Discretion" Is Too Much Discretion: An Analysis of Delaware's Online Shareholder Meeting Statutory Model, KAN. J.L. & PUB. POL'Y, 207 (2013-2014).

management may pre-screen questions to avoid difficult issues,¹⁹⁶ and that in a virtual format shareholders more generally will be unable to engage in meaningful dialogue with one another and management.¹⁹⁷ In 2017, Glass Lewis, a leading proxy advisor, announced that it would recommend voting against directors of corporations whose firms convene virtual meetings that confer fewer rights than traditional in-person meetings.¹⁹⁸ In light of the coronavirus pandemic, proxy advisors held their fire on the use of virtual meetings during the 2020 and 2021 proxy seasons.¹⁹⁹ This approval, however, was expressly conditioned on the pandemic, not on an overarching change in approach.²⁰⁰ In early 2021, while extending its acceptance of virtual meetings for 2021, Glass Lewis reiterated its

¹⁹⁶Lisa M. Fairfax, *Virtual Meetings Reconsidered*, 40 SETON HALL L. REV. 1367, 1392-94 (2010) ("First, such a format may enable management to ignore difficult issues raised by shareholders because management may be able to easily ignore emails altogether but would find it more difficult to ignore shareholder questions posed at the physical meeting. Second, even if management responds to some email questions, advocates express concern that management will only respond to favorable questions."). At least at first, corporations answered all questions presented at the virtual only meeting. Anatoli van der Krans, *The Virtual Shareholders Meeting: How to Make it Work*, 2 J. INT'L COMMERCIAL L. & TECH 32, 34 (2007). Not clear if this has continued. It would seemingly be impossible for large corporations to answer every question.

¹⁹⁷Lisa M. Fairfax, *Virtual Meetings Reconsidered*, 40 SETON HALL L. REV. 1367, 1392-94 (2010).

¹⁹⁸Laura Weiss, *Proxy Adviser Cracks Down on Lack of Female Directors, Virtual Meetings*, CONG. Q. ROLL CALL (Nov. 27, 2017), <https://www.rollcall.com/author/laura-weiss>.

¹⁹⁹E.g., Aaron Bertinetti, *Glass Lewis Guidelines Update on Virtual Only Meetings due to COVID-19 (Coronavirus)*, GLASS LEWIS BLOG (March 19, 2020),

<https://www.glasslewis.com/immediate-glass-lewis-guidelines-update-on-virtual-only-meetings-due-to-covid-19-coronavirus> (pledging to take the pandemic into account for the 2020 proxy season); ISS Global Policy Board, *Impacts of the Covid-19 Pandemic*, ISS POLICY GUIDANCE, (April 8, 2020),

<https://www.issgovernance.com/file/policy/active/americas/ISS-Policy-Guidance-for-Impacts-of-the-Coronavirus-Pandemic.pdf> (ISS pledged not to make "adverse vote recommendations related to companies holding 'virtual-only' meetings" in the subset of markets where ISS discourages them "until such time that it is safe to hold in-person meetings again.").

²⁰⁰Aaron Bertinetti, *Glass Lewis Guidelines Update on Virtual-Only Meetings Due to COVID-19 (Coronavirus)*, GLASS LEWIS BLOG (Mar. 19, 2020), <https://www.glasslewis.com/immediate-glass-lewis-guidelines-update-on-virtual-only-meetings-due-to-covid-19-coronavirus> ("Finally, for all shareholder meetings occurring after June 30, 2020, our standard policy on virtual shareholder meetings will apply, and we expect robust disclosure in the proxy statement concerning shareholder participation."); see also Council of Institutional Investors, Press Release, *CII Statement on Virtual Shareholder Meetings During Public Health Emergency*, (Mar. 16, 2020), <https://www.cii.org/march2020virtualmeetings> (emphasizing that support for virtual only meetings "is a one-off, tailored for current circumstances").

concerns about the potential for virtual meetings to reduce shareholder participation.²⁰¹

Some scholars have argued that virtual shareholder meetings have the potential to expand the reach of shareholder meeting access.²⁰² That said, they significantly enhance board control over the form, flow, and character of shareholder meetings. Boards have enjoyed sole discretion over whether to convene a virtual meeting and how to structure it; the pandemic experience seems unlikely to alter this.

9. Shareholder Requests to Inspect Corporate Books and Records

Section 220 of the DGCL gives shareholders the right to review corporate books and records for "any proper purpose" reasonably related to her interests as a shareholder,²⁰³ but the board enjoys considerable discretion over the ease with which shareholders can do so. This power to determine the mechanics of keeping and ultimately making available books and records can greatly impact the ease at which shareholders can search corporate records under a § 220 demand.²⁰⁴

Section 220 provides that a stockholder "shall, upon written demand . . . have the right during the usual hours for business to inspect for any proper purpose, and to make copies and extracts from . . . [t]he corporation's stock ledger, a list of its stockholders, and its other books and records."²⁰⁵ Pursuant to DGCL § 224, the board may store books and records in any form, so long as such records can be quickly converted into "clearly legible paper."²⁰⁶ Either a paper format or an electronic database would satisfy this requirement,²⁰⁷ but firms need not, for example, make

²⁰¹Andrew Gebelin, *Glass Lewis' Updated Approach to Virtual Meetings Globally*, (Jan. 14, 2021), GLASS LEWIS BLOG, <https://www.glasslewis.com/glass-lewis-updated-approach-to-virtual-meetings-globally/>.

²⁰²See, e.g., Yaron Nili & Megan Shaner, *Virtual Annual Meetings: A Path Toward Shareholder Democracy and Stakeholder Engagement*, 63 B.C. L. REV. 125 (2022).

²⁰³DEL. CODE ANN. tit. 8 § 220 (2019).

²⁰⁴DEL. CODE ANN. tit. 8 § 220 (2019).

²⁰⁵DEL. CODE ANN. tit. 8 § 220(b) (2019).

²⁰⁶DEL. CODE ANN. tit. 8 § 224 (2019) ("Any records administered by or on behalf of the corporation in the regular course of its business, including its stock ledger, books of account, and minute books, may be kept on, or by means of, or be in the form of, *any information storage device, method, or 1 or more electronic networks or databases (including 1 or more distributed electronic networks or databases)*, provided that the records so kept can be converted into clearly legible paper form within a reasonable time.") (emphasis added).

²⁰⁷A. GILCHRIST SPARKS, III, *DELAWARE CORPORATION LAW AND PRACTICE* § 28.01 (2018); see also R. FRANKLIN BALOTTI & JESSE A. FINKELSTEIN, *BALOTTI AND FINKELSTEIN'S DELAWARE LAW OF CORPORATIONS AND BUSINESS ORGANIZATIONS* § 7.50

books and records accessible—even by password in a data room—to requesting shareholders over the internet. If a corporation retains solely paper records, a shareholder's inspection of its books and records "during the usual hours for business" will likely be more time consuming. In contrast, searchable electronic records allow shareholders—and the corporation itself—to more efficiently and effectively identify relevant documentation. Additionally, electronic records may offer cost and security advantages.

The breadth of the "proper purpose" prong is still being fleshed out, but in the first instance it is the board that determines whether a request is proper. Recently, the Delaware Supreme Court held that a "credible basis" to investigate possible wrongdoing or mismanagement will satisfy this requirement, without a need to demonstrate that such allegations are actionable.²⁰⁸ The board also helps predetermine the credibility of any basis for a claim of wrongdoing arising because it controls and oversees the disclosure of information that could give rise to such a basis in the first place.

C. Shareholder Powers Under the DGCL

Shareholders are granted specific and limited powers over the corporation. With a handful of exceptions, these powers exist in the form of potential energy, going kinetic only when the board brings forward a proposal requiring a shareholder vote. Additionally, shareholder powers primarily involve "end the game" transactions, such as to approve the corporation's sale or dissolution, where the right to oust directors is not deemed to be a mechanism for protecting shareholders' interests.

Certain subsets of shareholders—such as activist hedge funds, socially-minded shareholder activists, and institutional investors—exercise greater influence than this description would suggest. This influence is largely expressed informally, in private meetings with the

(2006) ("Delaware law does not prescribe the specific method by which corporate records are to be kept. Corporate records may be maintained in any form that may be converted into clearly legible written form within a reasonable period of time. Thus, any computerized or other method of information storage and retrieval is acceptable."); *Anderson v. Dobson*, No. 106CV2, 2007 WL 2462675, at *2 (W.D.N.C. Mar. 22, 2007) (noting "Delaware's now liberalized corporate records requirements, which allow ledgers and minutes to be maintained as electronic data files"), *report and recommendation adopted in part*, 627 F. Supp. 2d 619 (W.D.N.C. 2007); *Amalgamated Bank v. Yahoo! Inc.*, 132 A.3d 752, 792 (Del. Ch. 2016), *abrogated on other grounds by* *Tiger v. Boast Apparel, Inc.*, No. 23, 2019, 2019 WL 3683525 (Del. Aug. 7, 2019).

²⁰⁸See *AmerisourccBergen Corp. v. Lebanon Cty. Employees' Ret. Fund*, 243 A.3d 417, (Del. 2020).

board or managers or via the bully pulpit, for example through a proxy campaign or shareholder proposal. It has some attachment to law,²⁰⁹ but the extent of its influence is determined by the proponent's ability to persuade a large, diffuse group of shareholders. By contrast, as detailed in Parts II and III, *supra*, board powers are both more expansive and less subject to review. The narrow nature of statutory shareholder power—especially for retail shareholders, who fall outside these subgroups—underscores the overwhelming formal role of the board in firm governance. This subpart organizes shareholder powers and conducts a non-exhaustive review of them.

1. Election and Removal of Directors

The DGCL grants shareholders the exclusive right to elect directors.²¹⁰ However, few elections are meaningfully contested,²¹¹ and director nominees from management are typically approved by the shareholders in landslide victories. While shareholders have the power to remove directors, only a trivial percentage of directors are voted out.²¹² Whether this presents a problem or not turns on one's priors regarding a range of corporate governance issues.

²⁰⁹ *E.g.*, 17 C.F.R. § 240.14a-8 (allowing shareholders of public companies to make proposals to the full shareholder base that meet certain substantive and procedural criteria).

²¹⁰ DEL. CODE ANN. tit. 8 § 216(2)(2019)(electing directors); DEL. CODE ANN. tit 8 § 141(k) (removing directors).

²¹¹ For example, between 2014 and 2019 (the last season unaffected by the pandemic), out of thousands of companies traded on U.S. exchanges, there were never more than 76 proxy contests in a given year. *See* SULLIVAN & CROMWELL LLP, REVIEW AND ANALYSIS OF 2020 U.S. SHAREHOLDER ACTIVISM AND ACTIVIST SETTLEMENT AGREEMENTS 19 (Dec. 2, 2020), <https://www.sullcrom.com/files/upload/sc-publication-review-analysis-2020-US-shareholder-activism.pdf>.

²¹² *James J. Miller, 2021 Proxy Season Issues and Early Voting Trends*, HARV. L. SCH. F. ON CORP. GOVERNANCE (May 20, 2021) (noting that director nominees for S&P 500 companies received 96.7% support from investors in 2021), <https://corpgov.law.harvard.edu/2021/05/20/2021-proxy-season-issues-and-early-voting-trends>; Steven M. Haas & Lawton B. Way, *Corporate Governance: How Often Do Directors Fail to Receive Majority Support?*, HUNTON ANDREW KURTH (Oct. 2019) (noting that "[i]n 2019, 478 directors failed to receive majority support—a small number").

2. Mergers, Sales of Substantially all Corporate Assets, and Dissolution

True end-the-game transactions must be approved by shareholders. To finalize a sale of the corporation through either a stock purchase or merger with another firm, shareholders of "a majority of the outstanding stock of the corporation entitled to vote thereon" must approve the transaction.²¹³ Similarly, a sale of substantially all of the corporation's assets must be approved by the holders of a majority of the outstanding stock of the corporation.²¹⁴

Dissolution of the corporation must be approved by shareholders as well. While it can be accomplished by the shareholders acting by themselves, to do so requires a *unanimous* shareholder vote and thus is practically impossible for corporations with diffuse shareholder bases.²¹⁵ Thus, dissolution for such corporations is typically accomplished by an alternative procedure: the board initiates, and a majority of the shareholders approve.²¹⁶ Shareholders have a right to any assets that exist after the liabilities of the corporation have been satisfied.²¹⁷

3. Charter and Bylaw Amendments

The power to amend the certificate of incorporation and bylaws ultimately resides with shareholders, but is subject to qualifications. Charter amendments must be approved by a majority vote of the shareholders, but are initiated at the board level.²¹⁸ The power to amend, adopt, and repeal the bylaws of the corporation always rests with the

²¹³DEL. CODE ANN. tit 8 § 251(c)(2019)(mergers).

²¹⁴All or substantially all of the corporation's assets has been held to mean at least 50 percent of the corporation's assets, with more than 75 percent of the corporation's assets likely meeting the qualitative and quantitative test Delaware courts use to determine whether shareholder approval is required. *See Hollinger Inc. v. Hollinger Int'l, Inc.*, 858 A.2d 342 (Del. Ch. 2004); *Gimbel v. Signal Companies, Inc.*, 316 A.2d 599 (Del. Ch. 1974), *aff'd*, 316 A.2d 619 (Del. 1974).

²¹⁵DEL. CODE ANN. tit 8 § 275(c) (2019)("Dissolution of a corporation may also be authorized without action of the directors *if all the stockholders entitled to vote thereon* shall consent in writing and a certificate of dissolution shall be filed with the Secretary of State pursuant to subsection (d) of this section.") (emphasis added). Jay B. Kesten, *Shareholder Political Primacy*, 10 VA. L. & BUS. REV. 161, 230 n.343 (2016).

²¹⁶*See* DEL. CODE ANN. tit 8 § 275 (2019). Involuntary dissolutions are possible via alternative means in the bankruptcy process.

²¹⁷DEL. CODE ANN. tit 8 § 281 (2019) ("Any remaining assets [of the dissolved corporation] shall be distributed to the stockholders of the dissolved corporation."); *N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla*, 930 A.2d 92, 101 (Del. 2007) ("When a corporation is solvent, those duties may be enforced by its shareholders, who have standing to bring derivative actions on behalf of the corporation because they are the ultimate beneficiaries of the corporation's growth and increased value.").

²¹⁸DEL. CODE ANN. tit 8 § 242(b)(1) (2019).

shareholders,²¹⁹ but the same, parallel powers can also be conferred upon the corporation's "governing body," i.e., the board, in the certificate of incorporation.²²⁰

4. Lawsuits against Directors and Officers

The right to initiate litigation by the corporation against directors or officers for breaches of fiduciary duty belongs to the corporation.²²¹ Shareholders possess a derivative right to bring such suits on the corporation's behalf, but the corporation retains the right to manage any litigation.²²² Additionally, the right to bring a shareholder suit derivatively is restricted to instances where a demand on the board of directors is either futile or excused.²²³ Shareholders retain the right to sue directly, usually for violations of their voting rights.²²⁴

5. Miscellaneous Rights Under Federal Securities Regulation

Shareholders also enjoy a variety of rights under federal securities laws and regulations. For example, they can bring a claim for securities fraud under Section 10(b) of the Securities Exchange Act of 1934.²²⁵ Except at exempt companies, they also have the right to participate in an advisory vote on executive compensation (a so-called "say-on-pay" vote)

²¹⁹DEL. CODE ANN. tit 8 § 109(a) (2019) ("After a corporation other than a nonstock corporation has received any payment for any of its stock, the power to adopt, amend or repeal bylaws shall be in the stockholders entitled to vote.").

²²⁰*Id.* ("Notwithstanding the foregoing, any corporation may, in its certificate of incorporation, confer the power to adopt, amend or repeal bylaws upon the directors or, in the case of a nonstock corporation, upon its governing body. The fact that such power has been so conferred upon the directors or governing body, as the case may be, shall not divest the stockholders or members of the power, nor limit their power to adopt, amend or repeal bylaws.").

²²¹*Schoon v. Smith*, 953 A.2d 196, 202 (Del. 2008) ("The derivative action was developed by equity to enable stockholders to sue in the corporation's name where those in control of the corporation refused to assert a claim belonging to the corporation. The nature of the derivative suit is two-fold: first, it is the equivalent of a suit by the stockholders to compel the corporation to sue; and second, it is a suit by the corporation, asserted by the stockholders in its behalf, against those liable to it.").

²²²DEL. CODE ANN. tit 8 § 325 (2019); *Kramer v. W. Pac. Indus., Inc.*, 546 A.2d 348, 351 (Del. 1988).

²²³*See* DEL. CODE ANN. tit 8 § 325 (2019); Del. R. Ch. Ct. 23.1; Del. L. of Corp. and Bus. Org. § 13.10 Derivative Actions—Generally.

²²⁴*Tooley v. Donaldson, Lufkin & Jenrette, Inc.*, 845 A.2d 1031, 1036 (Del. 2004) ("A stockholder who is directly injured, however, does retain the right to bring an individual action for injuries affecting his or her legal rights as a stockholder. Such a claim is distinct from an injury caused to the corporation alone. In such individual suits, the recovery or other relief flows directly to the stockholders, not to the corporation.").

²²⁵Securities Exchange Act, 15 U.S.C. § 10(b).

as well as a vote concerning the frequency of the say-on-pay vote.²²⁶ Shareholders meeting eligibility requirements may make proposals at the annual meeting.²²⁷ These rights are seen as providing some checks and mitigation of certain downside risks such as fraud, but in comparison to other powers over corporate policy, they are relatively inconsequential.

* * *

Three themes of shareholder legal powers stand out. First, shareholders hold the exclusive power to hire and fire directors, even if this power is often functionally delegated to the incumbent board, which nominates new directors.²²⁸ A measure of control over the nominating process is often delegated further to search firms.²²⁹ This could be a power of great consequence. However, mobilizing it by definition requires great resources, especially at large corporations with dispersed ownership. Even with such resources, the task remains an uphill one—a conundrum that was first expounded upon at length in 1932 by Berle and Means and has dominated corporate governance now for ninety years. There is no sign it is closer to being "solved" today.

Second, many shareholder powers are in the nature of an up or down approval rather than initiation, deliberation, or amendment. The powers are inert until the board first brings forward a resolution on which the shareholders are given the choice of either voting yes or no. This structure may be necessary for a large capital base but does not easily lend itself to mobilization except around the odd issue, such as a rare unfavorable say-on-pay advisory vote as a signal to the CEO or the board about firm performance or CEO compensation.²³⁰

Third, procedural and practical limitations frequently render certain rights that appear to vest considerable power, like derivative suits and unilateral dissolution, functionally moot.

Far from accident or oversight, the separation of ownership and control implied by the allocation of power described here reflects the design of the modern corporation, which centralizes power in the board.

²²⁶17 C.F.R. § 229, 240 and 249.

²²⁷17 C.F.R. § 240.14a-8.

²²⁸Ralph A. Walkling, *Director Appointments—Is It "Who You Know"?*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Apr. 7, 2017) ("[T]he incumbent board nominates new directors, who are almost always subsequently elected.").

²²⁹MATTEO TONELLO, CORPORATE BOARD PRACTICES IN THE RUSSELL 3000 AND S&P 500, at 32 (2019) (noting that "engagement of outside professionals in board searches has become a widely common practice, including among smaller companies").

²³⁰Heather Haddon, *Starbucks Shareholders Reject Executive Pay Proposal*, WALL ST. J. (Mar. 17, 2021), <https://www.wsj.com/articles/starbucks-shareholders-reject-executive-pay-proposal-11616020313>.

The primary checks on this are the market for corporate control (substantially suppressed by the poison pill), the market for stock (shareholders are free to sell their shares), and director elections. Of these, the last has proven the least effective. Consequently, while commanded to manage the firm for shareholders' benefit, the board's discretion about how to do so—in both the business and governance realm—is nearly total.

IV. BOARD DIVERSITY

Though it has diversified somewhat, the public company board is structured to represent shareholders, who make up only a narrow subset of corporate stakeholders. The current model therefore has only a limited claim to living up to pronouncements like that of the Business Roundtable in 2019 that it was embracing stakeholder capitalism.

Boards continue to contain a majority or supermajority of older, white male executives. In 2018, white men made up 66 percent of board seats in the Fortune 500.²³¹ In 2020, the average age of an S&P 500 director was 63.²³² While women comprise over half the management and professional labor force,²³³ they hold only 28 percent of such board seats.²³⁴ African Americans account for 8.6 percent of board seats at Fortune 500 companies, despite accounting for 13.4 percent of the U.S. population.²³⁵ The diversity deficit is even more stark in the C-suite, where 85 percent of Fortune 500 executives are white,²³⁶ far more than in the U.S. population as a whole.

Board composition is important from at least two perspectives: the quality of corporate policy decisions and the need for representative legitimacy. Homogeneous organizations are associated with an increased

²³¹Deloitte, *Missing Pieces Report: The 2018 Board Diversity Census Of Women And Minorities On Fortune 500 Boards* 17 (Jan. 16, 2019) <https://www2.deloitte.com/content/dam/Deloitte/us/Documents/center-for-board-effectiveness/us-cbe-missing-pieces-report-2018-board-diversity-census.pdf>.

²³²SPENCERSTUART, *2020 Spencer Stuart U.S. Board Index*, SPENCERSTUART (Dec. 2020) https://www.spencerstuart.com/-/media/2020/december/ssbi2020/2020_us_spencer_stuart_board_index.pdf

²³³U.S. BUREAU OF LABOR STATISTICS, BLS REPORTS, WOMEN IN THE LABOR FORCE: A DATABOOK, REPORT 1092 (Apr. 2021), <https://www.bls.gov/opub/reports/womens-databook/2020/home.htm#:~:text=In%202019%2C%2057.4%20percent%20of,of%2060.0%20percent%20in%201999.> ("Women accounted for 51.8 percent of all workers employed in management, professional, and related occupations in 2019").

²³⁴SPENCERSTUART, *supra* note 232.

²³⁵Chris Brummer & Leo E. Strine, *Duty and Diversity*, 75 VAND. L. REV. 1, 10 (2021).

²³⁶*Id.* at 15.

risk of unconscious bias, which can both undermine independent thinking²³⁸ and harm firm performance.²³⁹

The absence of diversity on boards has attracted growing critical attention.²⁴⁰ Some evidence links representation of a wider range of perspectives and backgrounds on boards to material changes in board activity and performance. More diverse boards have been shown to be less susceptible to groupthink and in-group bias.²⁴¹ These risks have long plagued board decisionmaking²⁴² and there is reason to believe that diversity can act as a counterweight. In addition, a board that reflects the shareholders it is charged to champion would presumably be seen as a more legitimate board. To the extent that shareholders have interests beyond wealth maximization, or to the extent that the new corporate pluralism signals a rise in benefit corporations, a stakeholder conception of traditional corporations, or both, this may be even more desirable.

This Part analyzes the current and historic makeup of the board and highlights recent interventions by state governments and a major stock exchange to increase the representativeness of boards. Additionally, this Part considers how the legitimacy-enhancing function of diversity could accelerate an activation of the board's latent powers.

²³⁸See, e.g., *id.* at 21 ("Individuals, regardless of race, tend to like individuals who are similar to themselves and evaluate them more positively than those who are different. Because of this 'affinity bias,' managers may repeatedly favor individuals who are similar to themselves, viewing them as more trustworthy, intelligent, or qualified."); Shill, *The Independent Board as Shield*, 77 Wash. & Lee L. Rev. at 1843–62; Nili, *supra* note 166, at 118–23; Antony Page, *Unconscious Bias and the Limits of Director Independence*, 2009 U. ILL. L. REV. 237 (2009).

²³⁹For a discussion of this literature, including important nuances and director interviews, see Stephanie J. Creary, et al., *When and Why Diversity Improves Your Board's Performance*, HARV. BUS. R. (Mar. 27, 2019), <https://hbr.org/2019/03/when-and-why-diversity-improves-your-boards-performance>.

²⁴⁰See, e.g., Brummer & Strine, *supra* note 235, at 10.

²⁴¹See, e.g., Sujin K. Horwitz & Irwin B. Horwitz, *The Effects of Team Diversity on Team Outcomes: A Meta-Analytic Review of Team Demography*, 33 J. OF MGMT. 987 (2007) (conducting a meta-analysis of team diversity and concluding that "cognitive resources of members (i.e., functional expertise or industry experience) may matter more than members' innate demographic diversity (i.e., ethnicity or gender)"). Importantly, while the researchers did not find a positive relationship between demographic diversity and team performance, they also did not find a negative one. *Id.* at 1009. More recent studies have suggested a positive relationship; others show no relationship. In the face of these results, some scholars advocate moving away from a focus on "performance" narrowly defined and towards normative social policy goals. See, e.g., James A. Fanto, Lawrence M. Solan & John M. Darley, *Justifying Board Diversity*, 89 N.C. L. REV. 901 (2011).

²⁴²See Shill (2020), *supra* note 9, at 1843–62; Antony Page, *Unconscious Bias and the Limits of Director Independence*, 2009 U. ILL. L. REV. 237, 259 (2009).

A. Board Composition and Turnover

Despite the shift in the purpose of the board from advising to monitoring, one aspect of the board has remained constant: the board is disproportionately older, white, and male.²⁴³ The boardroom and C-suite's resistance to diversity has endured despite more successful shifts in numerous other areas. In 2020, "enhancing racial/ethnic diversity" was identified as a top priority by nominations and governance committee chairs at 76 percent of a sampling of S&P 500 firms.²⁴⁴

Corporate boards are edging towards greater representativeness. In 2010, 84.3 percent of directors in the Fortune 500²⁴⁵ were male; by 2018, the figure was 77.5 percent.²⁴⁶ In the same period, people of color on Fortune 500 boards increased from 12.8 percent to 16.1 percent.²⁴⁷ That these numbers were as low as they were in 2010 and have only increased slowly since that time is a function in part of the structure and norms governing corporate boards.

Directors are rarely voted off boards by shareholders.²⁴⁸ Additionally, director tenure exceeds ten years on average.²⁴⁹ Such long tenure is no surprise, due to the workload (a self-reported five hours a week) and compensation directors enjoy.²⁵⁰ Thus, the project of diversifying the board has proceeded in part not by seeking the resignation

²⁴³See, e.g., Deloitte, *supra* note 231, at 17; Annalisa Barrett, *Age Diversity Within Boards of Directors of the S&P 500 Companies*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Apr. 6, 2017) (noting the median age of *Fortune 500* directors is 62.4), <https://corpgov.law.harvard.edu/2017/04/06/age-diversity-within-boards-of-directors-of-the-sp-500-companies>.

²⁴⁴SPENCERSTUART, *supra* note 232, at 34.

²⁴⁵This paper focuses primarily on board diversity in larger corporations primarily because this is where the most accurate and detailed information lies. However, it is worth noting that diversity efforts in smaller public corporations and private startups seem to be lagging behind their larger brethren. Lauren Rivera et al., *Research: Gender Diversity on Start-Up Boards Is Worse Than You Think*, HARV. BUS. R. (Dec. 11, 2019), <https://hbr.org/2019/12/research-gender-diversity-on-start-up-boards-is-worse-than-you-think> (noting that women hold only 20% of board seats in the Russell 3000 and just over 7% in "the boards of 200 of the most heavily funded U.S.-based, private, venture-backed companies").

²⁴⁶Deloitte, *supra* note 231, at 17.

²⁴⁷*Id.*

²⁴⁸Nili, *supra* note 166, at 122 ("While directors must earn shareholder approval in order to be elected to the board--though in some cases the approval threshold for reelection is very minimal--their true dependency lies with management and their peers. Because the overwhelming majority of director elections are uncontested, inclusion in the company's ballot is paramount to a director's ability to be elected and to subsequently hold her seat.").

²⁴⁹Dan Marcecc, *CEO Tenure Rates*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Feb. 12, 2018), <https://corpgov.law.harvard.edu/2018/02/12/ceo-tenure-rates>.

²⁵⁰See Shill (2017), *supra* note 9, at 1267.

or retirement of longstanding, largely homogenous directors but rather, by adding seats to the board, and then seating new, more diverse directors alongside the old directors.²⁵¹ For example, during the 2020 proxy year, 59 percent of new independent directors on S&P 500 boards were women, people of color, or both.²⁵² In a report covering that season, board consultancy Spencer Stuart noted:

[B]oards face a conundrum: how to address calls to increase the perspectives in the boardroom when so few seats open—less than one per S&P 500 board—in a given year. One option is to increase the size of the board. That is the route some boards take: Of the 272 boards that appointed new independent directors during the 2020 proxy year, 28% increased the size of the board to add women (on a net basis after independent director departures).²⁵³

This approach has two major downsides. First, it can lead to boards that are too large. For this reason, Spencer Stuart advises, "increasing the board size is not a sustainable option and, in our experience, most boards consider around 10 directors the optimal size."²⁵⁴ In addition, the choice to proceed in this fashion prioritizes the body's status quo dynamics (a phenomenon that will be familiar to any student of industrial organization), at the cost of the pace of change. It is commonly believed that social upheaval in 2020 and increased attention to racial justice has led boards to accelerate the movement towards greater diversity on boards,²⁵⁵ so the future course of these dynamics may change from their past trajectory.

B. State Interventions to Advance Board Diversity

The call for greater board diversity is not new. Academics, activists, and a growing share of business leaders have highlighted the need for greater representation in recent years.²⁵⁶ Recently, however, a new and

²⁵¹SPENCERSTUART, *supra* note 232, at 4.

²⁵²*Id.* at 5.

²⁵³*Id.* at 1 (emphasis removed).

²⁵⁴*Id.* at 5.

²⁵⁵SPENCERSTUART, *supra* note 232, at 31.

²⁵⁶*See, e.g.*, James A. Fanto, Lawrence M. Solan & John M. Darley, *Justifying Board Diversity*, 89 N.C. L. REV. 901 (2011); Sarah Crouse, *BlackRock: Companies Should Have at Least Two Female Directors*, WALL ST. J. (Feb. 2, 2018),

powerful voice has entered the fray—state governments. Through their police power, state governments have already enacted or are considering enacting various requirements establishing minimum levels of board diversity or board diversity disclosures for corporations within their borders.²⁵⁷ Such requirements, which are new in the United States, are not uncommon elsewhere in the world.²⁵⁸ Board diversity mandates in other countries, as one would expect, are associated with higher levels of diversity.²⁵⁹ The new state requirements in the U.S., though they mostly set a low bar or merely require disclosure (rather than specific membership percentages), underscore the salience of board diversity not only in the market for corporate influence but in policy.

This subpart will highlight the recently enacted and proposed measures to encourage or require greater board diversity. These actions either require board diversity by statute, encourage it through resolutions and targets, or mandate certain disclosures, with the hopes of nudging corporations towards greater diversity through transparency.

1. California S.B. 826: Mandatory Board Gender Diversity

The earliest and likely most influential minimum diversity statute belongs to California: Senate Bill 826 ("S.B. 826"). The statute, which was enacted in 2018, applies to those public corporations whose "principal executive offices" are located within California, as disclosed on the corporation's Form 10-K.²⁶⁰ The statute's requirements phase in over time. The first step mandated at least one female director by the end of 2019; by

<https://www.wsj.com/articles/blackrock-companies-should-have-at-least-two-female-directors-1517598407>.

²⁵⁷S. Con. Res. 62, (CA 2013); S. Res. 3469, 218th Leg (N.J. 2019); Michigan's Senate Bill No. 115; Illinois law, Public Act 101-0589.

²⁵⁸DELOITTE, *WOMEN IN THE BOARDROOM: A GLOBAL PERSPECTIVE* (5th ed. 2019)(noting gender diversity mandates of various types in countries as diverse as France, Germany, India, and Malaysia); Celia Huber & Sara O'Rourke, *How to accelerate gender diversity on boards*, MCKINSEY & CO. (Jan. 16, 2017), <https://www.mckinsey.com/featured-insights/leadership/how-to-accelerate-gender-diversity-on-boards> ("Women currently hold 19 percent of board positions there, while in European countries such as France, Norway, and Sweden, where legislative or voluntary targets are in place, they hold more than 30 percent.").

²⁵⁹Albertine d'Hoop-Azar et al., *Gender Parity on Boards Around the World*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Jan. 5, 2017), <https://corpgov.law.harvard.edu/2017/01/05/gender-parity-on-boards-around-the-world> ("At first glance, the greatest predictor of a more gender-diverse board seems to be the strength of any regulation mandating some minimum level of diversity. Stronger regulations with mandates for minimum gender representations are in place in many of the markets with the highest percentage of female directors, while markets with less stringent regulations or no mandates tend to have fewer female directors.").

²⁶⁰Cal. Corp. Code § 301.3 (Deering 2019).

the end of 2021, boards with five directors must have at least two women, and boards with six or more directors must have at least three women.²⁶¹ Covered corporations that fail to implement the quota are fined \$100,000 for a first violation and \$300,000 for subsequent violations.²⁶² The statute does not speak to racial diversity in the boardroom.

The statute's validity is currently being litigated. At least three court challenges have been filed.²⁶³ The first, *Crest v. Alex Padilla*, sought to enjoin the California Secretary of State from spending taxpayer money on enforcement of the statute.²⁶⁴ The plaintiff claimed that the mandate was unconstitutional under the Equal Protection Clause of the state constitution.²⁶⁵ At this time, there have been no definitive rulings on the various challenges to the statute.²⁶⁶

Many covered corporations in California have failed to comply with the statute. Per the California Secretary of State, only 330 of the 625 corporations that fall under the statute filed the mandatory 2019 Corporate Disclosure Statement.²⁶⁷ Thus, some 295 corporations, whether intentionally or with a lack of awareness, have failed to report on the

²⁶¹*Id.*

²⁶²*Id.*

²⁶³Michael Hatcher and Weldon Latham, *States are Leading the Charge to Corporate Boards: Diversify!*, HARV. L. SCH. F. ON CORP. GOVERNANCE (May 12, 2020), <https://corpgov.law.harvard.edu/2020/05/12/states-arc-leading-the-charge-to-corporate-boards-diversify>.

²⁶⁴Complaint for Declaratory and Injunctive Relief, *Crest v. Padilla*, No. 19STCV27561, 2019 WL 3771990 (Cal. Super. Ct. 2019); Cydney S. Posner, *A First Challenge to California's Board Gender Diversity Law*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Sept. 4, 2019), <https://corpgov.law.harvard.edu/2019/09/04/a-first-challenge-to-californias-board-gender-diversity-law>.

²⁶⁵Complaint for Declaratory and Injunctive Relief, *Crest v. Padilla*, No. 19STCV27561, 2019 WL 3771990 (Cal. Super. Ct. 2019); Posner, *supra* note 264; Chris Brummer & Leo E. Strine, *Duty and Diversity*, 75 VAND. L. REV. 1, 58 (2021) (observing that with regard to mandatory board membership quotas, "the threat of constitutional challenge is clear").

²⁶⁶In 2020, the plaintiff was held to have standing, but the court did not reach the merits. Other lawsuits are in different stages. See David A. Bell, Dawn Belt & Jennifer J. Hitchcock, *New Law Requires Diversity on Boards of California-Based Companies*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Oct. 10, 2020), <https://corpgov.law.harvard.edu/2020/10/10/new-law-requires-diversity-on-boards-of-california-based-companies/>; Hatcher, *supra* note 263.

²⁶⁷See CALIFORNIA SECRETARY OF STATE, *Women on Boards: March 2020 Report 3* (last visited May 17, 2022), <https://bpd.cdn.sos.ca.gov/women-on-boards/WOB-Report-04.pdf>; Casey Leins, *Report: Some California Corporations Ignore Law Requiring Females on Boards*, U.S. NEWS (Mar. 4, 2020 at 3:17 p.m.), <https://www.usnews.com/news/best-states/articles/2020-03-04/many-california-corporations-refuse-to-follow-gender-diversity-law-report-finds>.

diversity of their boardrooms.²⁶⁸ Additionally, 48 of the 330 corporations that did make the required disclosure reported they had zero female directors.²⁶⁹

While a few other states have adopted disclosure mandates or are discussing membership quotas, as of 2021 California is the only U.S. state that mandates any form of board diversity.²⁷⁰

2. California A.B. 979: Mandatory Board Representation from Underrepresented Communities

In 2020, California extended the logic and structure of its gender diversity mandate ("S.B. 826") to additional groups by enacting Assembly Bill 979 ("A.B. 979").²⁷¹ The law requires that California headquartered public companies have at least one director from an underrepresented community on their board.²⁷² Under the statute, this term comprises "an individual who self-identifies as Black, African American, Hispanic, Latino, Asian, Pacific Islander, Native American, Native Hawaiian, or Alaska Native, or who self-identifies as gay, lesbian, bisexual, or transgender."²⁷³

By the end of 2022, each covered company must have a minimum number of directors from underrepresented communities. As with S.B. 826, the minimum quota is determined by board size.²⁷⁴

3. Maryland Senate Bill 911: Mandatory Board Gender Disclosure

In 2019, Maryland enacted a law requiring companies headquartered within its borders to annually disclose their total number of directors and their total number of female directors.²⁷⁵ Notably, the statute

²⁶⁸See CALIFORNIA SECRETARY OF STATE, *supra* note 267, at 3; Leins, *supra* note 317.

²⁶⁹See CALIFORNIA SECRETARY OF STATE, *supra* note 267; Casey Leins, *Report: Some California Corporations Ignore Law Requiring Females on Boards*, U.S. NEWS (Mar. 4, 2020 at 3:17 p.m), <https://www.usnews.com/news/best-states/articles/2020-03-04/many-california-corporations-refuse-to-follow-gender-diversity-law-report-finds>.

²⁷⁰Hatcher, *supra* note 263.

²⁷¹AB-979 Corporations: boards of directors: underrepresented communities, CAL. LEGIS. INFO. (Oct. 2, 2020), https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=201920200AB979.

²⁷²*Id.*

²⁷³*Id.*

²⁷⁴Boards with a total of four or fewer directors must include at least one director from underrepresented communities; boards with five must have at least two such directors, and; boards with six or more must have at least three such directors. *Id.*

²⁷⁵Maryland SB911 Gender Diversity in the Boardroom – Annual Report, TRACKBILL, <https://trackbill.com/bill/maryland-senate-bill-911-gender-diversity-in-the-boardroom-annual-report/1688203/>; Luwanda Jenkins, *New 'gender diversity in the boardroom'*

applies to a wider universe of entities than California's; the Maryland statute applies to corporations (public and privately held), limited liability companies, trusts, and other entities with sales or an operating exceeding \$5 million.²⁷⁶ Entities of which 75 percent or more of the shareholders are family members are exempt.²⁷⁷ The statute, Maryland Senate Bill 911, is set to sunset in 2029, unless it is extended.²⁷⁸

4. Illinois HB 3384: Mandatory Public Company Board Disclosure

Like Maryland, in 2019 Illinois enacted a statute (House Bill 3384 ("HB 3394")) requiring certain companies to annually disclose board diversity.²⁷⁹ However, the law's structure, scope, and requirements differ significantly from its Maryland counterpart; although limited to disclosure, the Illinois law incorporates some of the spirit of the more expansive California law.

Illinois' HB 3394 applies solely to publicly held corporations with their principal place of business within the state, thus more closely matching the scope of the California statute.²⁸⁰ The Illinois law also requires significantly more detailed disclosure. It requires corporations to disclose the gender, racial, and ethnic diversity of their board.²⁸¹ In addition, corporations must disclose details about their director election process, director qualifications, and the extent to which diversity is considered.²⁸⁴ They must also provide a description of the corporation's policies and practices that encourage diversity.²⁸⁵

5. New York Business Corporation Law Section 408: Mandatory Board Gender Disclosure

Effective in 2020, New York amended its corporate filing requirement to include "[t]he number of directors constituting the board and how many directors of such board are women."²⁸⁶ In terms of

law places Maryland companies on notice, THE DAILY RECORD (Nov. 22, 2019), <https://thedailyrecord.com/2019/11/22/new-gender-diversity-in-the-boardroom-law-places-maryland-companies-on-notice>; Hatcher, *supra* note 217.

²⁷⁶Hatcher, *supra* note 263.

²⁷⁷Hatcher, *supra* note 263.

²⁷⁸Hatcher, *supra* note 263.

²⁷⁹Business Corporation Act of 1983, 805 ILCS 5/8.12, 805 ILCS 5/14.05 (West 2019); Hatcher, *supra* note 263.

²⁸⁰Business Corporation Act of 1983, 805 ILCS 5/8.12, 805 ILCS 5/14.05 (West 2019).

²⁸¹*Id.*

²⁸⁴*Id.*

²⁸⁵*Id.*

²⁸⁶N.Y. Bus. Corp. Law § 408 (McKinney 2019).

jurisdiction, the requirement goes beyond some of the other laws; it applies to all corporations doing business in New York.²⁸⁷ The amendment was styled as facilitating a "study," through which New York would learn about the change in female directors over time.²⁸⁸ The first study was issued on February 1, 2022, with additional studies released every four years thereafter.²⁸⁹

6. Colorado HJR 17-1017: Encouragement of Gender Diversity

Prior to California's mandate, the Colorado General Assembly passed a non-binding legislative resolution encouraging increased gender diversity on the boards of publicly held corporations headquartered in Colorado.²⁹⁰ The resolution urged progress by December 2020.²⁹¹ Similar to the California statute, the resolution establishes diversity targets: corporations with five or fewer directors are urged to aim for a minimum of one woman director; those with five to eight, for at least two woman directors; and those nine or more, for 3 or more women.²⁹²

7. Other States Considering Mandatory Gender Diversity

At least five other states²⁹³ have mandatory gender diversity bills under consideration, each at various steps along the path to possibly becoming law. Each of these bills track the jurisdictional limitation of the California model by only applying to publicly held domestic or foreign corporations with their principal corporate offices located within the

²⁸⁷*Id.*

²⁸⁸Teri Wilford Wood & Anna Broccolo, *New York Enacts Legislation Related to Board Diversity*, NAT'L L. REV. (Jan. 17, 2020), <https://www.natlawreview.com/article/new-york-enacts-legislation-related-to-board-diversity>.

²⁸⁹*Id.* See also Doreen E. Lilienfeld et al., *NEW YORK STATE REQUIRES COMPANIES TO REPORT ON NUMBER OF WOMEN CORPORATE BOARD DIRECTORS* (Jan. 31, 2020), <https://www.shearman.com/perspectives/2020/01/new-york-state-requires-companies-to-report-on-number-of-women-corporate-board-directors>.

²⁹⁰Colo. H.J. Res. 17-1017 (2017); *CO General Assembly Passes Resolution Promoting Equitable Gender Representation on Corporate Boards on International Women's Day*, BUS. WIRE (Mar. 8, 2017), <https://www.businesswire.com/news/home/20170308006471/en/General-Assembly-Passes-Resolution-Promoting-Equitable-Gender>.

²⁹¹*Id.*

²⁹²*Id.*

²⁹³Michael Hatcher and Weldon Latham, *States are Leading the Charge to Corporate Boards: Diversify!*, HARV. L. SCH. F. CORP. GOVERNANCE (May 12, 2020), <https://corpgov.law.harvard.edu/2020/05/12/states-are-leading-the-charge-to-corporate-boards-diversify> (identifying the states of Hawaii, Massachusetts, Michigan, New Jersey, and Washington).

state.²⁹⁴ However, they vary in at least three important ways: the number of female directors required for compliance, the deadline for corporations to comply, and the penalties for noncompliance.²⁹⁵

C. Nasdaq Rule 5605(f)

In addition to state legislative movements toward greater board diversity, stock exchanges have recently entered the fray, with one of the two largest U.S. exchanges taking the lead. In December 2020, Nasdaq submitted a proposal to the Securities and Exchange Commission ("SEC") to adopt a new Rule 5605(f) concerning Diverse Board Representation,²⁹⁶ which would adopt a comply-or-explain approach to board diversity along both gender and ethnic dimensions. On August 6, 2021, the SEC approved the new listing rules. Specifically, with certain exceptions for foreign issuers, smaller reporting companies, and companies with five or fewer directors, the rule requires that a company listed on the Nasdaq exchange "must have, or explain why it does not have, at least two members of its board of directors who are Diverse, including (i) at least one Diverse director who self-identifies as Female; and (ii) at least one Diverse director who self-identifies as an Underrepresented Minority or LGBTQ+."²⁹⁷ Companies with five or fewer directors must have at least one member who is diverse, or explain why it does not have at least one diverse member.²⁹⁸

In its proposal to the SEC, Nasdaq emphasized its view that "the national market system and the public interest would best be served by an additional regulatory impetus for companies to embrace meaningful and multi-dimensional diversification of their boards."³⁰⁰ It also noted "the heightened focus on corporate board diversity by companies, investors, corporate governance organizations, and legislators" and how this focus "demonstrates that investor confidence is enhanced when boardrooms are comprised of more than one demographic group."³⁰¹

²⁹⁴*Id.*

²⁹⁵*Id.* (containing a chart highlighting these three variables and how they differ across these bills).

²⁹⁶*Proposed Rule Change*, SEC. AND EXCH. COMM'N 3 (Dec. 1, 2020), <https://listingcenter.Nasdaq.com/assets/RuleBook/Nasdaq/filings/SR-Nasdaq-2020-081.pdf>.

²⁹⁷NASDAQ Rule 5605(f), <https://listingcenter.nasdaq.com/rulebook/nasdaq/rules/nasdaq-5600-series>.

²⁹⁸*Id.*

³⁰⁰*Id.* at 6.

³⁰¹*Id.* at 5 (internal citations omitted).

The Nasdaq rule mirrors California's approach in many ways, most directly by parroting the comply-or-explain structure that eschews an actual diversity mandate. More notable than its structure, however, is the entrant of a new and influential player—a leading stock exchange—into the board diversity arena.³⁰²

D. Measurement Challenges and Broader Opportunities

Generally speaking, diverse groups tend to outperform non-diverse groups, at least when both groups are high-functioning, as one would expect with a group like a board.³⁰³ This would suggest an obvious logic to enhancing the diversity of boards. Nevertheless, and despite making up over half of the management and professional workforce, women remain underrepresented in both the boardroom and among executives. As discussed above, this lack of gender diversity has persisted for decades and has been slow to change,³⁰⁴ suggesting the possibility of a market failure. Relative to their share of the population, people of color are also underrepresented on boards.

The impact of racial and gender diversity on board activity and performance has been studied extensively. Scholars have come to varying conclusions, with some finding performance advantages among diverse boards and businesses more broadly that provide empirical support for increased diversity.³⁰⁵ For example, one study by a search firm suggested diverse boards perform better—as measured by increased activity, better monitoring, and improved firm performance—when they are representative of the shareholder base they serve, at least once such representation reaches a "critical mass."³⁰⁶ Others have found evidence of

³⁰²Just as California's board diversity statute sparked criticism and lawsuits, editorials have also expressed dismay towards Nasdaq's proposal. *The Woke Nasdaq*, WALL ST. J. (Dec. 1, 2020), https://www.wsj.com/articles/the-woke-nasdaq-11606865986?mod=article_inline

³⁰³Lu Hong & Scott E. Page, *Groups of Diverse Problem Solvers Can Outperform Groups of High-Ability Problem Solvers*, 101 PROC. NAT'L ACAD. SCI. U.S. 16385, 16389 (2004).

³⁰⁴See Part IV, *supra*.

³⁰⁵See, e.g., Chris Brummer & Leo E. Strine, *Duty and Diversity*, 75 VAND. L. REV. 1, 26 (2021) (concluding that "organizations with inclusive cultures" are likely to perform better along various metrics).

³⁰⁶See Cynthia Soledad, et al., *2018 Global Board Diversity Tracker: Who's Really On Board?*, EGON ZEHNDER (December 2018), <https://www.egonzehnder.com/global-board-diversity-tracker/download>.

such a relationship inconclusive or that measurement is complicated by other factors.³⁰⁷

Boards bear primary responsibility for corporate decisionmaking. The impact of diversity on board performance can be understood as occurring along two dimensions: (1) the firm's financial performance and (2) the board's governance. The former presents a difficult causal inference problem, given the presence of confounding variables. Board governance asks a more straightforward, but more subjective question: how does diversity alter board processes, decisionmaking, dynamics, and monitoring?

1. Diversity and Firm Performance

A host of studies have found an association between gender diversity and corporate performance.³⁰⁸ A recent study by Credit Suisse found that corporations with fifteen percent or more gender diversity outperformed less representative corporations.³⁰⁹ The study tracked performance from 2010 to 2019, and found that greater representation in both the C-suite and boardroom correlated positively with share-price performance over the same period.³¹⁰ Additionally, MCSI in 2015 and 2016 found that boards with "strong female leadership"³¹¹ outperformed

³⁰⁷See Chris Brummer & Leo E. Strine, *Duty and Diversity*, 75 VAND. L. REV. 1, 28 (2021) (noting that a meta-analysis of 20 studies covering 3,097 companies concluded that "female representation on corporate boards has a 'small and non-significant' relationship with a company's financial performance."); Katherine Klein, *Does Gender Diversity on Boards Really Boost Company Performance?*, U. OF PENN. THE WHARTON SCH. (May 18, 2017), <https://knowledge.wharton.upenn.edu/article/will-gender-diversity-boards-really-boost-company-performance>.

³⁰⁸See, e.g., Lois Joy, et al., *The Bottom Line: Corporate Performance And Women's Representation On Boards*, CATALYST (2007), https://www.catalyst.org/system/files/The_Bottom_Line_Corporate_Performance_and_Womens_Representation_on_Boards.pdf [<https://perma.cc/45NP-WQDP>]; Jasmin Joecks, Kerstin Pull & Karin Vetter, *Gender Diversity in the Boardroom and Firm Performance: What Exactly Constitutes a "Critical Mass?"*, 118 J. BUS. ETHICS 61 (2012); Joana Marinova, Janneke Plantenga & Chantal Remery, *Gender Diversity & Firm Performance: Evidence from Dutch and Danish Boardrooms*, 27 INT'L J. HUM. RESOURCE MGMT. 1777 (2016).

³⁰⁹*The CS Gender 3000 in 2019: The changing face of companies*, CREDIT SUISSE 19-21 (2021).

³¹⁰*Id.*

³¹¹Meggin Thwing Eastman, Daimon Rallis & Gaia Mazzucchelli, *The Tipping Point: Women on Boards and Financial Performance* 6, MSCI (2016), https://30percentclub.org/assets/uploads/UK/Third_Party_Reports/MSCI_The_Tipping_Point_-_WOB_Financial_Performance.pdf. (Companies with either i) a female CEO and at least one

boards with no women, using earnings per share and return on equity as metrics.³¹² While this evidence is encouraging, some maintain that it is difficult to attribute causality to the outcome of "firm performance."³¹⁴ For example, corporations that are struggling financially tend to face more investor pressure to make changes, including to their boards.³¹⁵ Even if they do change their board composition, though, they may continue to struggle.³¹⁶ This might seem to suggest an absence of benefits from diversifying leadership, when in reality it may reflect weak fundamental conditions at the firm.³¹⁷ These inference challenges make confident causal conclusions difficult, but associations can convey useful information.

Social pressure over the slow pace of change is clearly a factor in driving the investment community's recent enthusiastic embrace of diversity in the boardroom.³¹⁸ The #MeToo and #TimesUp social movements³¹⁹ have been credited with increasing the salience of gender diversity as have the racial justice protests of 2020 for racial diversity.³²⁰

female board member iii) three or more women on the board, or iii) a higher than country average percentage of women on the board.)

³¹²*Id.* at 6-8.

³¹⁴Klein, *supra* note 307; *see also* Renée B. Adams & Daniel Ferreira, *Women in the Boardroom and Their Impact on Governance and Performance*, 94 J. FIN. ECON. 291, 308 (2009) (failing to find a causal link between gender diversity and stock performance).

³¹⁵Michelle K. Ryan & S. Alexander Haslam, *The Glass Cliff: Evidence that Women are Over-Represented in Precarious Leadership Positions*, 16 BRIT. J. MGMT. 81, 83 (2005).

³¹⁶*Id.* at 84.

³¹⁷*Id.* at 81 (arguing that women are "more likely than men to find themselves on a 'glass cliff,' such that their [management] positions are risky or precarious.").

³¹⁸Sarah Crouse, *BlackRock: Companies Should Have at Least Two Female Directors*, WALL ST. J. (Feb. 2, 2018), <https://www.wsj.com/articles/blackrock-companies-should-have-at-least-two-female-directors-1517598407>; Emily Chasan, *BlackRock Puts Its Votes Behind Proposals to Get Women on Boards*, BLOOMBERG (July 13, 2017), <https://www.bloomberg.com/news/articles/2017-07-14/blackrock-puts-its-votes-behind-proposals-to-get-women-on-boards>; Ryan Vlastelica, *Vanguard Calls for More Diverse Corporate Boards, Better Climate-Change Disclosures*, MARKETWATCH (Sept. 1, 2017), <https://www.marketwatch.com/story/vanguard-calls-for-more-diverse-corporate-boards-better-climate-change-disclosures-2017-08-31>. For a broader discussion on the recent shift by investors and proxy advisors, which is reflected in shareholder proposals, *see* Yaron Nili, *Beyond the Numbers: Substantive Gender Diversity in Boardrooms*, 94 IND. L.J. 145, 156-57 (2019).

³¹⁹*See* David A. Katz & Laura A. McIntosh, *Corporate Governance Update: Shareholder Activism Is the Next Step of #MeToo*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Sept. 28, 2018), <https://corpgov.law.harvard.edu/2018/09/28/corporate-governance-update-shareholder-activism-is-the-next-phase-of-metoo/>.

³²⁰SPENCERSTUART, *supra* note 232.

2. Diversity and Firm Governance

With regard to governance, diverse boards have been associated with improved monitoring, decisionmaking, and leadership.³²¹ A study by McKinsey & Company found that women more frequently use positive leadership behaviors than men, especially in the areas of work environment and accountability.³²² Additionally, studies from other countries indicate diverse boards are more active, more vigilant, and more willing to replace underperforming senior management.³²³ These are just a few of the myriad studies that tie greater gender diversity to more effective governance.³²⁴ Here, too, the casual inference puzzle is complicated.³²⁵ For example, women directors have been found to be "tougher" monitors of management when it comes to CEO compensation and CEO dismissal decisions.³²⁶ A team of scholars tested that finding by examining the variable of director geographic remoteness from firm headquarters, and concluded that women directors tend to live considerably further from the corporation on whose board they serve than do their male counterparts.³²⁷ The scholars also found that distant directors make for tougher monitors and that controlling for the difference in distance by sex explained essentially all of the variation in "toughness" of monitoring in the sampled firms.³²⁸ This counsels for an understanding of locational attributes and other constraints that intersect with gender

³²¹Chris Brummer & Leo E. Strine, *Duty and Diversity*, 75 VAND. L. REV. 1, 33–34 (2021) ("When faced with complex strategic issues necessitating out-of-the-box thinking, cognitively diverse groups will be able to leverage a broader range of information and possible solutions for consideration than homogeneous groups.").

³²²*Women in the Workplace 2021*, MCKINSEY & COMPANY 17 (2021), <https://www.mckinsey.com/featured-insights/diversity-and-inclusion/women-in-the-workplace>.

³²³AARON A. DHIR, CHALLENGING BOARDROOM HOMOGENEITY: CORPORATE LAW, GOVERNANCE, AND DIVERSITY 149-150 (2015); Miriam Schwartz-Ziv, *Gender and Board Activeness: The Role of a Critical Mass*, 52 J. FIN. & QUANTITATIVE ANALYSIS 751, 751 (2017).

³²⁴See also Sandeep Gopalan & Katherine Watson, *An Agency Theoretical Approach to Corporate Board Diversity*, 52 SAN DIEGO L. REV. 1, 20 (2015).

³²⁵Zinat S. Alam, et al., *Gender and Geography in the Boardroom: What Really Matters for Board Decisions?* 1 (Dec. 2018) (working paper), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3336445.

³²⁶*Id.* at 23.

³²⁷*Id.* at Abstract.

³²⁸*Id.*

identity and race,³³⁰ so that the pursuit of diversity goals can be made more effective.³³¹

The experience to date on board gender diversity suggests that firms need to do more to integrate women effectively into the power structure of the board. While boards remain overwhelmingly male, women who do become directors remain underutilized and overburdened,³³² suggesting that substantive gender diversity remains perhaps even more elusive than the numbers would indicate. Woman directors tend to remain on the board for shorter periods of time (despite being younger than their male counterparts, on average),³³³ occupy far fewer leadership positions,³³⁴ and be stretched between a higher number of boards at one time than men.³³⁵ It remains to be seen whether the new energy and mandates around board diversity address these issues that might endogenously undermine the success of women directors.

Among the various types of diversity on boards, the push for gender diversity has had the greatest success. Notably, however, the push for racial diversity in the boardroom rapidly increased during the latter half of 2020, in light of the racial justice protests following the killing of George Floyd on May 25 of that year and increased attention to similar incidents.³³⁶ Indeed, the number of Black board members appointed to corporate boards increased in the wake of that and other high-profile incidents of violence against unarmed Black people.³³⁷

³³⁰See, e.g., Te-Ping Chen, *To Attract Black Employees, Companies Move to Them*, WALL ST. J. (Mar. 20, 2021), <https://www.wsj.com/articles/to-attract-black-employees-companies-move-to-them-11616212810>.

³³¹See Gregory H. Shill, *Corporate Governance in Spatial Equilibrium* (working paper).

³³²Nili, *supra* note 166, at 152.

³³³Nili, *supra* note 166, at 168–70 (noting that, from 2007–2015, “men had an average tenure of between 1.99 (22%) and 2.64 (27%) years longer than women” despite male directors being, on average, over 3 and a half years older than their female counterparts during this time period).

³³⁴Nili, *supra* note 166, at 170–72.

³³⁵Nili, *supra* note 166, at 172–73 (“The average number of boards on which female directors sit on has remained relatively constant throughout the time period starting at 1.97 boards in 2007 to 1.95 boards in 2015. For men, however, the average number of boards has decreased from 1.88 to 1.78 over the same period.”).

³³⁶Brummer & Strine, *supra* note 235, at 19.

³³⁷Leslie P. Norton, *The Number of Black Board Members Surged After George Floyd's Death*, BARRON'S (Oct. 27, 2020), <https://www.barrons.com/articles/after-george-floyds-death-the-number-of-black-board-members-surges-51603809011>.

Diversity at the board level can enhance performance and quality of governance.³³⁸ However, in an atmosphere of greater corporate pluralism, diversity need not be justified by these profit-centric goals alone. As scholars have argued, efforts to increase board diversity can be more overtly public-minded and normative in their objectives.³³⁹ Board diversity can also serve as a signal to a corporation's customers, employees, and other stakeholders that the board represents everyone with whom the corporation interacts.³⁴⁰ This would dovetail with a more pluralistic conception of corporate purpose, including pushes for disclosure on topics of broader interest to stakeholders and other efforts to broaden the firm's focus and responsibilities.³⁴¹

V. ESG: THE SIGNAL AND THE NOISE

Efforts to incorporate environmental, social, and governance factors into corporate purpose have been building for years. In 2020, however, they reached a tipping point.³⁴² ESG progress is reflected in three developments, which in turn suggest a more pluralistic conception of corporate law. The first is a recent change in policy by a prominent national business group. This surprise announcement was significant both in itself and in the reception it found in corporate America. The second is the growth of benefit corporations, which explicitly embrace public interest as one aspect of corporate purpose. And the third is the explosion of assets under management in recent years of investment funds that offer an ESG emphasis.

All of these developments are accompanied by important qualifications. Nevertheless, in combination, they signal increased interest in a conception of the firm that goes beyond shareholder wealth

³³⁸James A. Fanto, Lawrence M. Solan & John M. Darley, *Justifying Board Diversity*, 89 N.C. L. REV. 901, 930 (2011)

³³⁹*See Id.* at 901 (arguing that board diversity should be reconceived along these lines).

³⁴⁰*Id.* at 931.

³⁴¹*See, e.g.*, Ann M. Lipton, *Not Everything Is About Investors: The Case for Mandatory Stakeholder Disclosure*, 37 YALE J. REG. 499 (2019).

³⁴²*See, e.g.*, John Borneman, Tatyana Day & Olivia Viorhis, *2021 ESG & Incentives Report*, HARV. F. ON CORP GOVERNANCE (July 8, 2021), <https://corpgov.law.harvard.edu/2021/07/08/2021-esg-incentives-report/> (expressing the view of executive compensation and corporate strategy consultants at the firm Semler Brossy that "ESG has become one of the most prominent set of issues discussed in boardrooms across the country over the past year.").

maximization, and thus may both signify and help to bring about the new pluralism.

A. The Business Roundtable Endorsement of Stakeholderism

The first development is a major declared policy change among business elites, most significantly by the Business Roundtable ("BRT"), which in August 2019 explicitly embraced the stakeholder conception of the firm.³⁴³ The second trend consists of a growing set of stakeholder governance legislative initiatives, notably the Accountable Capitalism Act proposed by Senator Elizabeth Warren.³⁴⁴ Senator Warren's 2020 presidential campaign featured this bill prominently³⁴⁵ and raised the salience of the issue.

The BRT represents the CEOs of "America's leading companies," which directly employ 20 million people and boast annual revenues exceeding \$9 trillion.³⁴⁶ The organization is regarded as the most prominent mouthpiece for corporate America on matters of corporate governance, tax, and business regulation. While the sincerity and depth of the BRT's commitment to this change is the subject of some debate, the symbolic power of this change is uncontested.³⁴⁷ In 1970, Milton Friedman famously declared "the social responsibility of business is to increase its profits";³⁴⁸ in the 1970s and 1980s, this slowly became the ethos of business schools, business people, and corporate lawyers; and since 1997, it has also been the declared position of the BRT.³⁴⁹ The organization has

³⁴³*Business Roundtable Redefines the Purpose of a Corporation to Promote 'An Economy That Serves All Americans'*, BUS. ROUNDTABLE (Aug. 19, 2019), <https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans>.

³⁴⁴See Accountable Capitalism Act, S. 348, 115th Cong. (2018), <https://www.congress.gov/bill/115th-congress/senate-bill/3348>. Sen. Tammy Baldwin, a colleague of Sen. Warren, also proposed a bill with overlapping purposes. See Reward Work Act, S. 2605, 115th Cong. (2018) <https://www.congress.gov/bill/115th-congress/senate-bill/2605>.

³⁴⁵See, ElizabethWarren.com, *Empowering Workers Through Accountable Capitalism*, <https://elizabethwarren.com/plans/accountable-capitalism>.

³⁴⁶*About Us*, BUS. ROUNDTABLE, <https://www.businessroundtable.org/about-us>.

³⁴⁷See Stephen M. Bainbridge, *Making Sense of the Business Roundtable's Reversal on Corporate Purpose*, 46 J. CORP. L. 285, 285-89, 312-14 (2021); Andrew Winston, *Is the Business Roundtable Statement Just Empty Rhetoric?*, HARV. BUS. REV. (Aug. 30, 2019), <https://hbr.org/2019/08/is-the-business-roundtable-statement-just-empty-rhetoric>.

³⁴⁸Milton Friedman, *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>.

³⁴⁹See Winston, *supra* note 347.

not been known to advocate for employees or any other constituency besides shareholders.

The announcement was a major news event as well. *The Wall Street Journal* termed it a "major philosophical shift"³⁵⁰ and *The New York Times* noted it broke with "decades of long-held corporate orthodoxy."³⁵¹ It was soon followed by similar statements of other top business leaders, including the Davos World Economic Forum, which issued a "manifesto" on Stakeholder Capitalism a few months later in January 2020.³⁵²

Like the other initiatives, the BRT statement was not issued in a vacuum. Stephen Bainbridge, a leading advocate of the wealth maximization vision of the firm, has mused that it might have been a cynical effort at deflection.³⁵³ He posits two explanations. The first is that the BRT may be attempting to "greenwash" its member corporations—that is, trying to create a misleading conception that they now serve environmental and other public-minded objectives—for the purpose of increasing their appeal to some stakeholders, such as customers, employees, or even shareholders³⁵⁴ who attach a high priority to non-pecuniary interests.³⁵⁵ Some scholars have underscored the actual or potential role that institutional investors and hedge funds play here.³⁵⁶ The second is that the savvy CEOs aspired to head off political pressure, such as the Accountable Capitalism Act.³⁵⁷ Both are occurring amid a trend towards what supporters and detractors alike have referred to as "woke capitalism," in which investors and the public expect higher ethical standards and more public-minded behavior by corporations.³⁵⁸ This trend,

- higher ethical standards

³⁵⁰David Benoit, *Move Over, Shareholders: Top CEOs Say Companies Have Obligations to Society*, WALL ST. J. (Aug. 19, 2019), <https://www.wsj.com/articles/business-roundtable-steps-back-from-milton-friedman-theory-11566205200>.

³⁵¹David Gelles & David Yaffe-Bellany, *Shareholder Value Is No Longer Everything, Top C.E.O.s Say*, N.Y. TIMES (Aug. 19, 2019), <https://www.nytimes.com/2019/08/19/business/business-roundtable-ceos-corporations.html>.

³⁵²World Economic Forum, *Stakeholder Capitalism: A Manifesto for a Cohesive and Sustainable World* (Jan. 14, 2020), <https://www.weforum.org/press/2020/01/stakeholder-capitalism-a-manifesto-for-a-cohesive-and-sustainable-world/>.

³⁵³See generally Bainbridge, *supra* note 347.

³⁵⁴See Cathy Hwang & Yaron Nili, *Shareholder-Driven Stakeholderism*, U. CHI. L. REV. ONLINE 1, 1-4, 7, 9 (2020).

³⁵⁵See Bainbridge, *supra* note 347, at 311-12.

³⁵⁶See, e.g., Anna L. Christic, *The Agency Costs of Sustainable Capitalism*, 55 U.C. DAVIS L. REV. 875 (2021) (arguing this possibility for hedge funds); Madison Condon, *Externalities and the Common Owner*, 95 WASH. L. REV. 1, 27, 50, 61-63, 81 (2020) (explaining importance of institutional investors to the management of externalities).

³⁵⁷See Condon, *supra* note 356, at 23.

³⁵⁸Alana Semuels, *Why Corporations Can No Longer Avoid Politics*, TIME (Nov. 21, 2019), <https://time.com/5735415/woke-culture-political-companies/>.

which is surely multi-causal in origin, gained momentum during and in reaction to the presidency of Donald Trump.

The vehicle by which companies chose to adopt stakeholderism is notable. The most prominent commitment, by the BRT, was made by a body representing CEOs. But as has been detailed in this Article, it is the board and the board alone that has the power to set corporate policy.³⁵⁹

To gain full effect—and to ensure business judgment rule protection—a change in policy as significant as reorienting the very purpose of the corporation from serving shareholders to serving a broader set of stakeholders is the type of decision that would need to be made by a board rather than merely co-signed by a single executive, even the CEO. Yet, a study by Lucian Bebchuk and Roberto Tallarita found that only in a small minority of cases did a corporation that signed the BRT submit the decision to a board vote.³⁶⁰

Evidence about corporate priorities during the pandemic corroborates this view. For example, one scholar has observed "since the economic impacts of Covid-19 began, the [BRT] statement's signatories have paid out 20 percent more capital to shareholders than similar companies" and that they have been nearly "20 percent more likely to announce layoffs or worker furloughs."³⁶¹ Further, their executive compensation structures continue to prioritize shareholder returns.³⁶²

If boards began embracing the BRT statement, they would have at their disposal powerful levers to implement it. That may not be imminent, but other signs of movement towards stakeholderism are detectable elsewhere in the market.

B. Benefit Corporations

Investor interest in ESG is visible in the market for business entities. In recent years, the legislatures of Delaware³⁶³ and thirty-seven other states³⁶⁴ have created a new business form, the benefit corporation, that

³⁵⁹See discussion *supra* Part II.A.

³⁶⁰Lucian A. Bebchuk & Roberto Tallarita, *The Illusory Promise of Stakeholder Governance*, 106 CORNELL L. REV. 91, 98, 130-31, 133 (2020).

³⁶¹J.S. Nelson, *The Management Case for Inclusionary Corporate Purpose*, THE CLS BLUE SKY BLOG (Mar. 16, 2021), <https://clsbluesky.law.columbia.edu/2021/03/16/the-management-case-for-inclusionary-corporate-purpose>.

³⁶²*Id.*

³⁶³See, e.g., DEL. CODE ANN. tit. 8 § 365(a) (setting forth the attributes of benefit corporations). Most states refer to them simply as benefit corporations, and that term is used here.

³⁶⁴See Jill E. Fisch & Steven Davidoff Solomon, *The "Value" of a Public Benefit Corporation*, in RSCH. HANDBOOK ON CORP. PURPOSE AND PERSONHOOD 1, 4 (Elizabeth

explicitly declares the pursuit of public interest to be among the purposes of the corporation. While the law governing the traditional corporate form "already provides virtually complete protection to managers" who pursue stakeholder objectives,³⁶⁵ benefit corporations are expressly authorized to do so—that is, to prioritize those ends alongside or even above the maximization of shareholder wealth. This offers a variety of advantages, most of a "soft" nature such as the signaling of ESG-friendliness to employees and investors.

Generally, the challenge benefit corporations face is in signaling a credible commitment to this broader mandate without tying the hands of managers in a way that investors would find undesirable. To that end, B Lab, a non-profit that "was the driving force behind benefit corporation statutes,"³⁶⁶ offers an accrediting service; ESG-oriented businesses that meet certain criteria may, upon application, be deemed "Certified B Corporations" ("B Corps"). Some well-known brands, including Ben & Jerry's and Patagonia, have already been so certified.³⁶⁷ To qualify for B Corp certification, "a firm must have an explicit social or environmental mission, and a *legally binding* fiduciary responsibility to take into account the interests of workers, the community, and the environment, as well as its shareholders."³⁶⁸ To meet this requirement, "a company must also amend its articles of incorporation to adopt B Lab's commitment to sustainability and treating workers well."³⁶⁹ Given the policy flexibility that conventional corporations already enjoy, some have argued this kind of private standard-setting is an advantage of benefit corporation statutes.³⁷⁰

The requirement of a "legally binding" commitment in the firm's charter is in conceptual tension with corporate law's traditionally exclusive focus on shareholder wealth maximization. However, according to a recent study by Jill Fisch and Stephen Davidoff Solomon, this has thus far not posed a practical tension.³⁷¹ They examined the purpose statements of the most economically significant such firms—nine privately held and four

Pollman & Robert B. Thompson, eds., forthcoming)
https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3712532.

³⁶⁵See Joseph W. Yockey, *Does Social Enterprise Law Matter?*, 66 ALA. L. REV. 767, 786 (2015).

³⁶⁶Fisch, *supra* note 364, at 4.

³⁶⁷See *B Corp Directory*, <https://bcorporation.net/directory> (last checked Mar. 20, 2021) <https://bcorporation.net/>. As of March 20, 2021, there were over 3,800 certified B Corps.

³⁶⁸See *B Lab*, PATAGONIA, <https://www.patagonia.com/b-lab.html> (emphasis added).

³⁶⁹*Id.*

³⁷⁰See Yockey, *supra* note 365, at 783–85.

³⁷¹Fisch & Davidoff Solomon, *supra* note 364, at 2.

publicly traded—and concluded that they were, "in most cases, too vague and aspirational to be legally significant."³⁷² They were too nebulous "even to serve as a reliable tool for evaluating whether corporate decisionmakers are adhering to [them]."³⁷³ The barriers to enforcing the corporation's social mission extend beyond definitional problems.

While the underlying purpose of benefit corporations is to expand the universe of the firm's concern, benefit corporation statutes do not authorize fiduciary duty litigation by stakeholders asserting a breach of the entity's social mission. Instead, only shareholders may sue. Even there, benefit-corporation shareholders seeking to hold firm decisionmakers accountable face a higher bar than their counterparts in conventional corporations. The Delaware statute, for example, "does not permit shareholder litigation unless initiated by at least 2% of the outstanding shares or, in the case of a publicly-traded [benefit corporation], \$2 million worth of stock."³⁷⁴ Shareholders in conventional corporations face no such bar.

The future of economically significant benefit corporations remains to be written. On one hand, investor pressure has caused some to abandon or scale back their public-minded commitments. Etsy, for example, terminated its B Corp certification in 2017 and reverted to shareholder primacy.³⁷⁵ On the other hand, recent market developments offer cause for benefit-corporation optimism. The most successful initial public offering of 2020 (in terms of opening-day stock appreciation) was Lemonade, a benefit corporation; Vital Farms, another benefit corporation, went public on its heels; and a third, Veeva Systems, in 2021 became the first public company to convert to a benefit corporation structure.³⁷⁶ Benefit corporations, including those that are publicly held, are poised to help shape the new corporate pluralism. With deep reservoirs of board power, their directors have blanket authority to do so.

³⁷²Fisch & Davidoff Solomon, *supra* note 364, at 2.

³⁷³Fisch & Davidoff Solomon, *supra* note 364, at 2.

³⁷⁴Fisch & Davidoff Solomon, *supra* note 364, at 18. Other states' statutes impose similar requirements; some also provide for a specialized "benefit enforcement proceeding," but often impose threshold holding requirements that are as high or higher as in a traditional suit for breach of fiduciary duty.

³⁷⁵Fisch & Davidoff Solomon, *supra* note 364, at 15–16.

³⁷⁶Fisch & Davidoff Solomon, *supra* note 364, at 5.

C. ESG Funds

Evidence of increased interest in stakeholderism can also be found in ESG funds. In recent years, leading institutional investors have established funds focusing on sustainable investing and have advised the public companies of which they are among the largest owners that they will be holding them accountable for achieving ESG goals.³⁷⁷ Until recently a footnote, ESG funds have seen major infusions in recent years, with inflows jumping from just under \$3 billion in 2015 to over \$17 billion in 2019,³⁷⁸ to a record \$51.1 billion in 2020.³⁷⁹ By one measure, total assets under management in ESG funds reached \$1.7 trillion globally in 2020.³⁸⁰ In a sign of the sector's growing maturity, corporate finance scholars have aimed in recent years to more rigorously define and test the authenticity and value-add of ESG funds.³⁸¹ In March 2021, the SEC lent support to the movement by proposing to inquire more forcefully into the accuracy of climate change disclosures by asset managers.³⁸²

In addition to the symbolism of the BRT statement and growing uptake in benefit corporations, the demand for ESG investments suggests support for mechanisms of commitment to a broad-minded vision of the corporation. Some of these investors simply believe that sustainability is good business, while others are willing to sacrifice some returns in exchange for a prosocial mission. The latter represents a straightforward divergence from classic shareholder wealth maximization, and the former

³⁷⁷See Dawn Lim & Julie Steinberg, *BlackRock to Hold Companies and Itself to Higher Standards on Climate Risk*, WALL ST. J. (Jan. 14, 2020), <https://www.wsj.com/articles/blackrock-shakes-up-sustainable-investing-business-following-criticism-11579000873>.

³⁷⁸See Juliet Chung & Dave Michaels, *ESG Funds Draw SEC Scrutiny*, WALL ST. J., (Dec. 16, 2019), <https://www.wsj.com/articles/esg-funds-draw-sec-scrutiny-11576492201>.

³⁷⁹See Dave Michaels, *Climate Change Emerges as a Compliance Focus for SEC*, WALL ST. J. (Mar. 3, 2021), <https://www.wsj.com/articles/climate-change-emerges-as-a-compliance-focus-for-sec-11614802615>.

³⁸⁰See Simon Jessop & Elizabeth Howcroft, *Sustainable Fund Assets Hit Record \$1.7 Trln in 2020: Morningstar*, REUTERS (Jan. 28, 2021), <https://www.reuters.com/article/us-global-funds-sustainable/sustainable-fund-assets-hit-record-1-7-trln-in-2020-morningstar-idUSKBN29X2NM>.

³⁸¹See, e.g., Bradford Cornell & Aswath Damodaran, *Valuing ESG: Doing Good or Sounding Good?*, (working paper, Mar. 20, 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3557432; Florian Berg, Julian F. Kolbel & Roberto Rigobon, *Aggregate Confusion: The Divergence of ESG Ratings*, (working paper May 17, 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3438533.

³⁸²See Michaels, *supra* note 379. The proposal is intended to determine "whether asset managers that tout funds as socially responsible are picking stocks that align with that cause, and whether the firms support environmentally-friendly policies at companies they have invested in."

implies a need for sufficiently profound changes that it holds similar implications.

VI. WHAT COULD A PLURALISTIC BOARD DO DIFFERENTLY? AN OPTIMISTIC CASE

The growing emphasis on both diversity and stakeholderism in the American board room is far from a check-the-box requirement. To the contrary, a shift in board makeup and purpose could accomplish the shift in power away from managers and towards the board that was envisioned in the independent-board movement. It could also change the character of those decisions. A more representative board that is emboldened by newfound legitimacy, and more involved in company leadership, culture, and strategy, could activate the latent powers of the board and harness them for the benefit of ESG-oriented shareholders, firm stakeholders, or both.

This Part sets forth an optimistic account of what a reconfigured board could accomplish by wielding the powers it was granted in the late-twentieth century push for an independent board. It articulates a bullish position—not because it believes a confident prediction of success for this embryonic shift is warranted, but in order to articulate more clearly the universe of possible changes. We concede the possibility that a reconfigured board would serve as a fig leaf for management, greenwashing its worst excesses and thereby perpetuating them.

Crucially, to reach potential, board changes of the sort that have been gaining momentum would need to do two things. First, they would need to achieve their declared objectives, be they diversity targets, stakeholder representation, or other socially-minded goals. Second, they would need to leverage the powers of the board that were expanded during the independent board revolution. A board able to marshal its dormant authorities in favor of a change in corporate purpose would be nothing short of transformational. Here, we explore how and why.

A. Diversity

A growing body of evidence in organizational behavior suggests that diverse groups make more well-informed decisions, are more likely to revisit unproductive precedents, and are less burdened by in-group bias

than their homogeneous counterparts.³⁸³ Some scholars have applied this observation to the boardroom specifically.³⁸⁴ To the extent C-suites remain relatively homogeneous in the near term, heterogeneous boards may help compensate. Even better, such boards may be better positioned to recruit, retain, and develop diverse talent than a board that lacks these characteristics.

1. The Diverse Board as Superior Monitor

Greater diversity could increase executive discipline through improved monitoring, oversight, and—when needed—pushback on corporate strategy. As Chris Brummer and former Delaware Chief Justice Leo E. Strine note, more diverse boards are "able to leverage a broader range of information and possible solutions for consideration than homogeneous groups."³⁸⁵ This capacity to critically analyze executive decisionmaking comes with it the possibility of a keener eye and firmer hand regarding unwise spending, empire-building, executive moonshots, runaway-train transactions, and other potential executive mismanagement or malfeasance. As part-time outsiders, the monitoring board as it exists today is largely limited in its ability to direct management towards long-term success, financially and otherwise. A board that is more capable of considering the complexities of the firm as a whole would be better suited to evaluating management's goals and motives than a homogeneous board.

Similarly, a heterogeneous board would be less beholden to the groupthink and related cognitive biases that have dogged the homogeneous makeup of both the boardroom and the C-suite.³⁸⁶ For example, one would expect a substantively independent board that is comparatively free of in-group bias to show greater openness to investigations, perhaps even including derivative suits that are aimed at holding managers accountable. This willingness to question management actions could improve management discipline and ensure management keeps the board more informed at the early stages of high level and material decisionmaking. Of course, it could also have negative consequences—for example, inefficient decisionmaking, higher costs of

³⁸³ See, e.g., Sujin K. Horwitz & Irwin B. Horwitz, *The Effects of Team Diversity on Team Outcomes: A Meta-Analytic Review of Team Demography*, 33 J. OF MGMT. 987 (2007)

³⁸⁴ See *supra*, Part IV.

³⁸⁵ Chris Brummer & Leo E. Strine, *Duty and Diversity*, 75 VAND. L. REV. 1, 33 (2021).

³⁸⁶ As Brummer and Strine point out, the C-suite lags even the board itself in terms of diversity, with a paltry 3.4 percent of Fortune 500 executives being African American. See *id.* at 15.

human capital (in terms of executive or director recruiting), or defensive management behavior. But at its best, it could represent the fulfillment of the longtime goal of shareholders' rights advocates of empowering a truly independent board to serve as a meaningful monitor.

2. Advancing the Diversity Imperative

A diverse board may be more likely or better positioned to ensure that the corporation follows through on diversity commitments in all areas of action. One can see this operating via several channels. Such a board may be more motivated to ensure the accomplishment of that goal. It would also have more authorities at its disposal to pursue it than would, say, a cadre of internal HR employees. The potential could be especially great in those corporations (which is probably all or nearly all public companies) that market their diversity efforts to shareholders and consumers. Failure to carry out diversification can negatively impact firm performance and expose directors and the company to securities law violations.³⁸⁷ A board reflecting the diversity goals of the corporation at large may pursue diversification efforts more seriously—and, if it doesn't, it may face increased scrutiny. In this way, diversity can act as both a sword to advance diversity efforts and a shield to blunt disclosure and fiduciary duty claims.

3. Reputation and Credibility

A diverse board is a more credible and legitimate board in the eyes of stakeholders. To that end, a board that embraces the imperative of diversity will likely be viewed by stakeholders, regulators, and possibly judges as one that functions more independently and effectively than one with the same makeup as management. Just as Delaware law and stock exchanges have required or prioritized the independent board and given it the ability to cleanse otherwise vulnerable conduct, a more diverse board could be viewed with similar favor because of its enhanced potential as a more engaged, less biased monitor.

In a similar vein, just as same begets same, difference may beget difference. A corporation that successfully diversifies its board of directors may be more effective at attracting diverse talent in other areas, like top management and recent graduates.³⁸⁸ Thus, a top-down approach from the

³⁸⁷*Id.* at 79 ("In a spate of new complaints, stockholder plaintiffs have alleged that companies are making untrue statements about their commitment to [diversity, equity, and inclusion] in their public disclosures, and thereby violating securities law.").

³⁸⁸*See id.* at 40 ("Having a diverse board or management may convey otherwise unobservable information to the public, like how receptive the company is to a diverse

boardroom seems a cost-effective way to signal to the market and stakeholders that the company is serious about a new paradigm. Further, a more diverse board may be seen as more credible when it requests that those seeking the company's business—outside lawyers, accountants, investment banks, and so on—meet diversity targets.³⁸⁹

B. Stakeholderism

Long favored by a segment of the U.S. corporate legal scholars, stakeholderism of various forms is common in continental European jurisdictions and some other countries.³⁹⁰ An American stakeholderism could take many different forms, from adding constituency stakeholders (say, from labor) to the board³⁹¹ to broadening boards' mandates so that they may more squarely consider, and more heavily weight, non-shareholder interests when making decisions. Like the initiatives around board diversity that have thus far gained more momentum, these proposals would increase board representativeness, perhaps enhancing the legitimacy of the board. Stakeholderism may also permit structural changes in the firm that enhance the reputation of firms themselves and the market as a whole, for example by scaling back historically high levels of executive compensation and making firms accountable for a broader range of internal constituencies when they engage in political spending.

1. New Board Structures to Include Stakeholders

Boards already enjoy the authority to advance the interests of stakeholder constituencies. They could use their control of capital allocation and structure decisions, executive and employee compensation, and even governance processes such as the board meeting format to increase representation of stakeholder interests. Mostly, the extent of changes that a stakeholder-minded board might embrace are limited not by law but by what its shareholders will tolerate. Strine advances several concrete steps that corporate boards could take to transition away from

workforce, or how open and inclusive the company's culture may be. These kinds of signals are important for securing top talent.").

³⁸⁹See *infra* Part VI.B.3.

³⁹⁰See, e.g., Christiaan de Brauw, *The Dutch Stakeholder Experience*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Aug. 2, 2020), <https://corpgov.law.harvard.edu/2020/08/02/the-dutch-stakeholder-experience>; Brandt, Fabian and Georgiou, Konstantinos, "Shareholders vs Stakeholders Capitalism" (2016). *Comparative Corporate Governance and Financial Regulation*.10. https://scholarship.law.upenn.edu/fisch_2016/10

³⁹¹See Grant M. Hayden & Matthew T. Bodie, *Codetermination in Theory and Practice*, 73 FLA. L. REV. 321 (2021) (reviewing recent empirical literature on codetermination, shared governance between shareholders and employees).

shareholder capitalism and towards what he refers to as "a fair capitalist economy function."³⁹² Among these is a recommendation that companies add workforce committees at the board level to "ensure quality wages and fair worker treatment."³⁹³ By dedicating a committee to the worker, he argues, boards can better ensure that employees more equitably share in the corporation's successes, both monetarily and non-monetarily.³⁹⁴ The former Chief Justice urges corporations to go further and "create European-style works councils" under the aegis of the workforce committee, "to amplify worker voice at all American companies, improve worker well-being, and support and supplement the vital role unions play in protecting workers."³⁹⁵ These changes, if adopted, would repeal the Friedman doctrine.

2. Board Capital Allocation Decisions

One of the most important decisions any board oversees is in the area of capital allocation. Not only how much to invest in one widget versus another, but how much to pay workers versus shareholders. There are a few examples of companies embracing a worker-friendly balance of these equities already. Dan Price, the CEO of Gravity Payments, a credit card processing company based in Seattle, raised the minimum salary at the corporation's headquarters to \$70,000 annually and cut his own \$1 million salary by 90 percent to do it.³⁹⁶ The move provided the company with significant positive press coverage, highlighting a potential downstream effect of ESG initiatives.³⁹⁷ By 2021, a few other CEOs had followed suit.³⁹⁸

The universe of possible capital allocation changes in favor of stakeholders is as vast as the universe of Friedman-type changes in favor of shareholders. A stakeholder model of corporate governance might result

³⁹²Leo E. Strine, *Toward Fair and Sustainable Capitalism* 4, (U. of Penn., Inst for Law & Econ Research Paper No. 19-39).

³⁹³*Id.* at 5.

³⁹⁴*Id.*

³⁹⁵*Id.*

³⁹⁶Lauren M. Johnson, *This CEO Raised the Minimum Salary of his Employees to \$70k and Now He's Doing It Again*, CNN (Sept. 25, 2019), <https://www.cnn.com/2019/09/25/business/gravity-increases-employee-minimum-salary-to-70k-trnd>. In 2019, he announced that employees at the company's Boise, Idaho office would see the same minimum salary by 2024.

³⁹⁷*Id.*; Stephanie Hegarty, *The Boss Who Put Everyone on 70k*, BBC NEWS (Feb. 28, 2020), <https://www.bbc.com/news/stories-51332811>.

³⁹⁸Dan Price, *The Gravity of \$70k*, GRAVITY PAYMENTS (last checked Mar. 20, 2021), <https://gravitypayments.com/thegravityof70k/#infographic-1>.

in fewer stock buybacks and dividend distributions. Shareholder wealth maximization incentivizes actions that immediately boost the share value of the company to benefit shareholders and executives, potentially at the expense of the other stakeholders.³⁹⁹ If a board were to include directors from stakeholder constituencies, such as labor or the community where the firm operates, these strategies would become more challenging.⁴⁰⁰

The sums involved are large and the issue has generated legislative interest. In fall 2019, the U.S. House of Representatives Committee on Financial Services invited economist and lawyer Lenore Palladino, then of the Roosevelt Institute think tank, to testify about corporations' capital allocation decisions.⁴⁰¹ In her testimony, she noted that major U.S. corporations have engaged in stock buybacks while laying off workers and instead of raising wages. "GM has spent \$10.6 billion on stock buybacks," she testified, "while engaging in layoffs and plant closures. That amounts to \$221,308 [in buybacks] for each of the 47,897 active UAW members currently on strike at GM."⁴⁰² She further observed that Walmart had spent \$9.2 billion on buybacks during the period August 2018 to July 2019, a sum that she calculated "could have been used to give a raise of roughly \$5/hour to each of its 1 million hourly workers instead."⁴⁰³ One could imagine a stakeholder board simply opting to allocate this money to workers rather than shareholders.

3. Board Policies for the Corporation and its Service Providers

One could imagine boards using their immense influence over corporate policy for different ends more generally. Starbucks provides an illustration. The Seattle-based chain said in 2020 that it would not only mandate anti-bias training for its executives, but tie their compensation to

³⁹⁹See, e.g., Andrew Keay, *Stakeholder Theory in Corporate Law: Has it Got What it Takes?*, 9 RICH. J. GLOB. L. BUS. 249, 256 (2010) (noting, "[T]he practice of managers transferring the costs of the corporation to stakeholders and retaining resulting benefits for shareholders," for example where the company "makes workers redundant so that dividends can be paid to shareholders and the share price will increase."). The author claims Shell boosted the value of its dividends by five percent after laying off 5,000 employees. *Id.* at n.42.

⁴⁰⁰See Zachary Needle, Note, *Who Will Watch the Watchers?: Enacting a Corporate Observing Board to Increase Consideration of Stakeholder Interests*, 89 FORDHAM L. REV. 763, 784 (2020).

⁴⁰¹Lenore Palladino, *Examining Corporate Priorities: The Impact of Stock Buybacks on Workers, Communities, and Investors*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Oct. 22, 2019), <https://corpgov.law.harvard.edu/2019/10/22/examining-corporate-priorities-the-impact-of-stock-buybacks-on-workers-communities-and-investors/>. Her particular focus was on curbing corporate buybacks.

⁴⁰²*Id.*

⁴⁰³*Id.*

increased minority representation among its workers (to 30 percent of U.S. corporate employees and 40 percent of U.S. retail and manufacturing employees).⁴⁰⁴ In January 2021, three years after becoming one of the first companies to commit to eliminating plastic straws, Starbucks also pledged to cut its carbon emissions and the waste it sends to landfills in half by 2030.⁴⁰⁵ Time will tell if these commitments are fulfilled. However, tensions between shareholder wealth maximization and top-of-market executive compensation are already clear. Just two months after the corporation's environmental commitment, the Starbucks board proposed a one-time bonus for the CEO of \$1.86 million—modest by large public company standards, but it was on top of a \$50 million pot of potential bonus money the board established for the CEO contingent on the achievement of certain targets.⁴⁰⁶

In addition to shaping their own companies, boards and management also hold tremendous power over the multitude of service professionals and firms that work at their behest. This power over accounting, financial, legal, and many other service industries creates an opportunity for corporations to advance change not only within their walls, but for the many individuals that rely on those corporations for their organizations' profitability and survival. Indeed, corporations are among the largest consumers of high-end professional services. They have long been aware of the leverage this provides them, but have traditionally used it for economic self-interest: favorable rates or rate structures, constant availability, and bulk pricing. However, corporations are beginning to apply this same influence to reach into hiring and staffing practices at professional services firms for other purposes. This is an instance where the goals motivating board diversity and stakeholderism merge.

⁴⁰⁴See Heather Haddon, *Starbucks Ties Executive Pay to 2025 Diversity Targets*, WALL ST. J. (Oct. 14, 2020), <https://www.wsj.com/articles/starbucks-ties-executive-pay-to-2025-diversity-targets-11602680401>.

⁴⁰⁵*Id.*

⁴⁰⁶*Id.* Shareholders rejected the proposed additional bonus, though the vote was advisory.

VII. CONCLUSION

The pace of social change over the past few years has accelerated, and corporate law is both being influenced by and helping to influence that change. After decades of talk, corporate law is now changing. Evidence of this can be seen in renewed debates over corporate purpose, but also in concrete measures at every level of the capital markets.

Boards are prioritizing diversity of membership. Elected officials, the SEC, institutional investors, and to a degree CEOs themselves are prioritizing ESG approaches. To judge from opinion polling and asset flows, these approaches appear to be popular with the general public and a critical mass of investors alike. The much-vaunted benefit corporation has gained ground, and traditional corporations are also showing some signs of co-opting its stated purpose of being public-regarding (at least in name). Though the depth of their commitment remains in question, CEOs have even signed on to a statement of stakeholder capitalism, a total reversal of a longstanding position. The growing demand for climate action and racial and gender equity appears to be adding momentum to these efforts and increasing the appeal of ESG in general.

These shifts are still taking shape, but at the center of all of them will be the board. The board's vast latent powers warrant deeper consideration. As board composition changes and the institution gains new representativeness and legitimacy, some of the factors underlying the board's longtime deference to managers may fade, which would pave the way for greater exercise of board power. The rising pluralism in corporate law—in terms of corporate purpose, board composition and diversity, stakeholder representation, and choice of corporate form—seems likely to have staying power. And in such an environment, the board's latent legal authorities will merit a closer look than they have under yesterday's governance regimes.

5

The Role of ESGs in the Corporate and Finance Sectors

Prof. Karen Jimeno

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LLM Program

San Beda Graduate School of Law

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