THE AMERICAN COLLEGE OF GOVERNANCE COUNSEL:
CHARTING THE COURSE TO AN
IMPROVED MODEL OF CORPORATE GOVERNANCE[1]

ABSTRACT

An important new body is contributing to the future of corporate governance. The American College of Governance Counsel (the "College") is a professional, educational, and honorary association of lawyers widely recognized for their achievements in the field of governance (the "Fellows"). The mission of the College is to promote a high level of professional standards among governance lawyers along with a better understanding and broader adoption of best practices within business organizations.[2]

At their first annual Colloquium in October 2015 (the "Colloquium"), the Fellows engaged in a wide-ranging debate about the current governance environment and the factors that have influenced its development – both for better and for worse. The discussion coalesced around two important points. The Fellows agreed that effective governance promotes sustainable value (for the long term, rather than the short term). There was also a strong consensus that in order to position businesses to operate with a view to long-term value, the relationships between shareholders (particularly activist shareholders) and boards of directors ("Boards") must be aligned to support that objective.

[1]This paper was prepared by Hansell LLP (Carol Hansell, Audrey DeMarsico and Frédéric Duguay) and law students Sam Kim (University of Toronto Faculty of Law) and John O'Toole (Widener University Delaware Law School), with important contributions from Jay H. Knight (Bass, Berry & Sims PLC), Julia Lapitskaya (Gibson, Dunn & Crutcher LLP), Toby D. Merchant (Squire Patton Boggs (US) LLP), Andrea Reed (Sidley Austin LLP), and John Mark Zeberkiewicz (Richards, Layton & Finger, PA).

[2]*Seasoned Leadership – For Clients. For the Profession.,* AMERICAN COLLEGE OF GOVERNANCE COUNSEL, http://www.amgovcollege.org/ (last visited, Dec. 8 2016).

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I. CONTEXT FOR THE COLLOQUIUM

The Fellows met in the New York offices of Gibson, Dunn & Crutcher LLP. John Olson (Chair of the College) opened the conference, followed by comments from Frank Placenti (President of the College). Mr. Olson and Mr. Placenti discussed the College's mission and the contributions the College and its Fellows can make to advance governance practices. Carol Hansell introduced the issues that the Fellows were being asked to address during the Colloquium. The results of the Fellows' deliberations are set out in this paper.

Discussions at the Colloquium were informed by the thoughts of four of the College's founding trustees. Ira Millstein provided opening comments,[3] which included responses to issues raised by Larry Sonsini in a keynote address delivered to the American Law Institute in May 2015.[4] Holly Gregory presented Mr. Millstein's comments, along with

[3]Ira M. Millstein, Senior Partner, Weil, Gotshal & Manges LLP, Remarks at the American College of Governance Counsel Inaugural Fellows' Colloquium, Opening Remarks (Oct. 30, 2015), *available at http://www.amgovcollege.org/uploads/7/8/4/7/78472964/holly-gregory-remarks-and-ira-millstein-keynote.pdf* [hereinafter Millstein Remarks].

[4]Larry W. Sonsini, Keynote Address at the ALI Life Member Class Luncheon, The Corporate Governance Landscape (May 19, 2015), *archived at https://perma.cc/6LJH-FW5U* [hereinafter Sonsini Address].

her own observations on the issues raised by Mr. Millstein and Mr. Sonsini.[5] The Fellows also had the benefit of a recent memorandum from Martin Lipton.[6] The themes that emerged from these comments and articles are discussed in Section 2 below.[7]

With the stage set, the Fellows participated in small group discussions of current and forward-looking trends in corporate governance. They discussed a range of issues facing governance practitioners and their clients including shareholder engagement, challenges to traditional models of governance, management of risks, and an increasingly complex regulatory and enforcement environment. The themes that emerged from these discussions are discussed in Section 3 below.[8] The Colloquium closed with a keynote address by Delaware Supreme Court Chief Justice Leo E. Strine, Jr.[9] An overview of Chief Justice Strine's remarks is set out in Section 4 below.[10] Section 5 recommends a role for the College to play in realigning the relationships between Boards and shareholders in order to create sustainable value in corporations and to benefit society as a whole.[11]

II. SETTING THE STAGE FOR THE COLLOQUIUM

A. *Lipton Memorandum*[12]

The College set the stage for the Colloquium with a selection of pre-reading materials, which included Martin Lipton's article "*Will a New Paradigm for Corporate Governance Bring Peace to the Thirty Years' War?*" Mr. Lipton compared the decades-long conflict between shareholder activists and Boards with the Thirty Years' War of the 17th century. He framed the corporate governance war as one between activist shareholders battling for a more shareholder-centric model of

[5] Holly J. Gregory, Remarks at the American College of Governance Counsel Inaugural Fellows' Colloquium, (Oct. 30, 2015), *archived at https://perma.cc/RV97-U6DK* [hereinafter Gregory Remarks].

[6] Martin Lipton, *Will a New Paradigm for Corporate Governance Bring Peace to the Thirty Years' War* WACHTELL, LIPTON, ROSEN, & KATZ (Oct. 2, 2015), http://www.wlrk.com/webdocs/wlrknew/WLRKMemos/WLRK/WLRK.24829.15.pdf [hereinafter Lipton Mem.].

[7] *See infra* Section 2.

[8] *See infra* Section 3.

[9] Leo E. Strine Jr., Keynote Address at the American College of Governance Counsel Inaugural Fellows' Colloquium, (Oct. 30, 2015), http://tinyurl.com/jj9fdnl [hereinafter Strine Keynote].

[10] *See infra* Section 4.

[11] *See infra* Section 5.

[12] Unless otherwise noted, the discussion throughout this section refers to and is supported by Martin Lipton’s October 2, 2012 memorandum. *See* Lipton Mem.

governance and corporations seeking to preserve the Board-centric approach to governance. In 1985, advocates of the Board-centric model won several important victories in the courts, while at the same time proponents of the shareholder-centric model were making progress on other fronts. The struggle between these two sides continues today. Mr. Lipton's article proposes a resolution to this ongoing conflict.

Mr. Lipton characterizes the two decades leading up to the 1985 decisions of the Delaware court in *Unocal Corp v Mesa Petroleum Co.*[13] ("*Unocal*") and *Moran v. Household International, Inc.*[14] ("*Household*") as a period in which corporate raiders were able to develop increasingly aggressive tactics, with public companies lacking the time or means to defend against those tactics. The conflicting interests of corporate raiders and their public-company targets were resolved in favor of the directors of those companies. The *Unocal* decision upheld the power of the Board to reject, and take action to defeat, a hostile takeover bid. The *Household* case affirmed the legality of the poison pill. The Board-centric model of governance had been validated.

However, 1985 was also a year of new beginnings for advocates of shareholder-centric governance. Mr. Lipton writes that they ". . . began their campaign to defy practical experience and reject the views of the people to whom we look not just to manage our great public business corporations, but to manage them in a manner designed to achieve the kind of success that leads to growth of the value of their businesses and their shares and the concomitant growth of GDP and the Nation's economy over the long term[.]"In 1985, both the Council of Institutional Investors ("CII") and Institutional Shareholder Services ("ISS") were created. "Ever since, ISS has been allied with CII and has routinely supported corporate governance proposals approved by CII and designed to promote shareholder-centric governance[.]" In 1994, the Department of Labor directed plan investment managers under the *Employee Retirement Income Security Act* ("ERISA") to exercise their voting authority in the interests of plan members (without clarifying that those interests could be long-term in nature). Several years later, the Securities and Exchange Commission (the "SEC") stated that this duty could be satisfied by voting in accordance with predetermined policies (and the recommendations of third parties such as proxy advisors) and required institutional investors to disclose how they vote on proxy issues. These developments resulted in growing reliance by institutional investors on the recommendations of proxy advisory firms. Finally, Mr. Lipton

[13]493 A.2d 946 (Del. 1985).
[14]500 A.2d 1346 (Del. 1985).

catalogued the regulation of corporate governance by Congress, the SEC, and stock exchanges. The net effect of legislative and regulatory actions over the past thirty years has been, he writes, the creation of ". . . an environment in which the corporate governance of public companies is highly regulated and there is little or no restraint on the tactics employed by activist hedge funds."

The Peace of Westphalia ended the Thirty Years' War and created a new paradigm for the governance of Europe. Similarly, Mr. Lipton proposed that a new paradigm for corporate governance could resolve the continuing tensions between advocates of the Board-centric and the shareholder-centric forms of corporate governance. Specifically, he suggested that a more reasonable balance could be restored through recognition that the proper goal of good corporate governance is creating sustainable value for the benefit of all stakeholders; resistance to the push for legislation, regulations or agency staff interpretations that place more power in the hands of investors with short-term perspectives; and inclusion in any new legislation or regulation of appropriate protection to companies.

B. *Sonsini Address*[15]

The text of the keynote address delivered in May 2015 by Larry W. Sonsini to the American Law Institute, titled "The Corporate Landscape," provided further context for the discussion at the Colloquium. In this address, Mr. Sonsini discussed the changes in the governance landscape over the last 10 years that have contributed to shareholder activism with multiple agendas. He highlighted seven key factors that have contributed to this change:

- the status of stock ownership (including the consolidation of ownership among a small group of large institutions and asset managers);
- the size and diversity of institutional investors;
- the proliferation of derivatives, synthetic securities, and hedging transactions;
- the continued influence of proxy advisory firms;

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[15]Unless otherwise noted, the discussion throughout this section refers to and is supported by Larry Sonsini's May 2015 remarks to the American Law Institute. *See* Sonsini Address.

- the politicizing of the boardroom (mainly as a result of limits on broker non-votes, majority voting in uncontested elections, the proxy access debate, and mandatory say on pay votes);
- scrutiny of "contextual" director independence; and
- the growth of corporate governance regulation (including the federalization of corporate law through *Sarbanes-Oxley Act of 2002* [16] ("SOX") and *Dodd-Frank Wall Street Reform and Consumer Protection*[17] ("Dodd-Frank")).

Mr. Sonsini described the activist market environment (including the capital available to activists and increased willingness of "long only" investors to become more active) as well as the increasingly sophisticated activist playbook (including multi-year campaigns; enlisting and incentivizing high-quality directors as nominees and a willingness to incur substantial expenses in pursuit of their objectives). All of this, Mr. Sonsini noted, has led to a debate about both the short-term and long-term effects of shareholder activism. Hedge fund activists will argue that they are prompting greater focus by Chief Executive Officers ("CEOs") on maximizing shareholder value and on business metrics. Critics believe that activism discourages investment (for example, by reducing capital spending or increasing debt to fund stock buybacks and dividends). Mr. Sonsini described the bid by Trian Fund Management, L.P.'s ("Trian's") Nelson Peltz ("Mr. Peltz") for seats on the Board of DuPont Co. ("DuPont") as a classic example of this debate. Trian was successful in winning support from some leading institutional investors, but was ultimately defeated by DuPont's strong corporate performance, enhanced transparency and effective communications with its shareholders. However, Mr. Peltz subsequently played a role in helping to plan and execute a merger between DuPont and its rival Dow Chemical Co.[18]

Mr. Sonsini offered detailed commentary on what the changes in the corporate governance landscape mean for Boards. Among other things, he recommends that Boards recognize that activism is well-funded, sophisticated, and committed and that activist agendas are broad and largely issue-driven. Directors should expect greater tension in the

[16]Pub. L. No. 107-204, 116 Stat. 745 (2002) [hereinafter SOX].

[17]Pub. L. No. 111-203, 124 Stat. 1376 (2010) [hereinafter Dodd-Frank].

[18]*See* David Benoit, *Dow, DuPont Deal Cements Activists' Rise*, THE WALL ST. J., Dec. 11, 2015, http://www.wsj.com/articles/dow-dupont-deal-cements-activists-rise-1449882586; s*ee also* Tom Hals, *DuPont Wins Board Proxy Fight Against Activist Investor Peltz*, REUTERS, May 13, 2015, http://reut.rs/1AWu5ka (discussing Peltz's failed proxy contest).

boardroom between long-term value creation and short-term value creation and that greater emphasis on shareholder communications will demand greater transparency on long-term strategic plans and more direct contact between directors and shareholders.

A. *Opening Remarks by Millstein and Gregory*[19]

In his opening remarks, Mr. Millstein responded to many of the issues raised by Mr. Sonsini in his address. Like Mr. Sonsini, he noted that there are problems in the current governance environment that need to be addressed and highlighted several of these problems to inform the discussions of the Fellows during the Colloquium.

Mr. Millstein drew the Fellows' attention to the double-agency problem created by an investment chain permeated by misaligned interests and conflicting motivations. Intermediaries such as pension funds, hedge funds, and mutual funds frequently have interests that conflict with the interests of their beneficiaries. Directors must sort through these various agendas and determine how they should proceed in the interests of the corporation as a whole.

In addition, Mr. Millstein discussed the legal standard to which directors are subject (with deference of the courts to prudently-made business decisions) and the market standard, which often seems to afford little deference to the work of the Board. He noted that market pressure can be positive if knowledgeable, or disruptive if not. Boards need to take a deeper look at market pressure (since few shareholders vote with full knowledge of the Board's actions). Like Mr. Lipton and Mr. Sonsini, Mr. Millstein was critical of proxy advisors who have "somehow convinced the market that they in fact know what is best for each and every corporation" as well as passive investors who blindly follow the voting recommendations of proxy advisors.

Mr. Millstein's remarks then turned to the role of the Fellows, as trusted advisors to Boards, in addressing the issues that have contributed to the misalignment of relationships in corporate governance. These observations are discussed in Section 5 of this paper.[20]

Ms. Gregory delivered Mr. Millstein's remarks on his behalf and elaborated on them. She recommended that the Fellows encourage directors to build trust relationships with investors through transparency and engagement, in the hopes that investors would default to a

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[19]Unless otherwise noted, the discussion throughout this section refers to and is supported by Ira Millstein's and Holly Gregory's opening remarks at the Colloquium. *See* Millstein Remarks; Gregory Remarks.

[20]*See infra* Section 5.

presumption that directors know best the business and are making business decisions on an informed basis and with the good-faith belief that the decisions will serve the best interests of the corporation. She concluded by saying "[j]ust as in the judicial review context, such a presumption built on trust grounded in transparency may be our best hope of dialing back the unrelenting pressures and unreasonable expectations that our Board clients are under, with potential for long-term benefit to the broader economy."

III. COLLOQUIUM DISCUSSION

Building on the pre-reading materials and the opening remarks, the discussion among the Fellows also focused on the governance conditions that will promote sustainable corporate enterprise value. The substance of the Fellows' discussions is set out below.

A. *Culture of Short-termism*

The Fellows discussed the factors that contribute to the continuing focus on short-term performance in many corporations. Some of those factors are not new.[21] Quarterly reporting gives investors, analysts, and media a regular scorecard that encourages a focus on short-term results, rather than long-term value.[22] CEOs and other corporate managers feel the pressure to meet short-term expectations or risk compromising the corporation's stock price (as well as the knock-on effects for shareholder value and executive compensation).[23]

The same is true of the activist agenda, which often focuses on short-term results.[24] In Delaware, courts have held that it is a valid exercise of business judgment for directors to prioritize long-term

[21] *See* Holly Gregory et al., *Report of the Task Force of the ABA Section of Business Law Corporate Governance Committee on Delineation of Governance Roles & Responsibilities*, 65 BUS. LAW 107, 145 (2010) [hereinafter ABA Report].

[22] Lawrence E. Mitchell, *The Legitimate Rights of Public Shareholders*, 66 WASH & LEE L. REV. 1635, 1645 (2009); Lynne L. Dallas & Jordan M. Barry, *Long-Term Shareholders and Time-Phased Voting,* 40 DEL. J. CORP. L. 541, 544 n.4, 558 n.51 (2016).

[23] *See* Leo E. Strine Jr., *Toward a True Corporate Republic: A Traditionalist Response to Bebchuk's Solution for Improving Corporate America*, 119 HARV. L. REV. 1759, 1764 (2006) [hereinafter Strine 2006] (noting that institutional investors' focus on quarterly benchmarks has led to managerial pressure and misconduct); Mitchell, *supra* note 22, at 1645; Dallas & Barry, *supra* note 22, at 560.

[24] Leo E. Strine, Jr., *The Dangers of Denial: The Need for a Clear-Eyed Understanding of the Power and Accountability Structure Established by the Delaware General Corporation Law*, 50 WAKE FOREST L. REV. 761, 790-91 (2015) [hereinafter Strine Dangers].

business interests over an immediate benefit to shareholders.[25] It is increasingly common, however, for activist investors to target companies with long-term business models for short-term exploitation.[26] Although directors may adopt defense measures to protect against such threats, the power of these measures has limited in recent years.[27]

Even when companies are able to stave off the initial efforts of short-term, activist investors, their success is often short-lived.[28] Whether the myopic influence of activist investors manifests itself in successful proxy contests or by existing Boards adopting short-term policies, it often brings about some degree of change.[29]

Many of the Fellows noted that communications and commentary about corporate performance have been further accelerated by social media.[30] Some Fellows noted that corporate communications need to catch up and do things faster as well.[31] Others noted that this challenges the ability of management and the Board to fulfill duties to take the time

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[25] Paramount Comm., Inc. v. Time, Inc., 571 A.2d 1140, 1154 (Del. 1989) ("The fiduciary duty to manage a corporate enterprise includes the selection of a time frame for achievement of corporate goals. That duty may not be delegated to stockholders. Directors are not obliged to abandon a deliberately conceived corporate plan for a short-term shareholder profit unless there is clearly no basis to sustain the corporate strategy.").

[26] Lynn A. Stout, *The Corporation As Time Machine: Intergenerational Equity, Intergenerational Efficiency, and the Corporate Form*, 38 SEATTLE U. L. REV. 685, 720 (2015); Iman Anabtawi & Lynn Stout, *Fiduciary Duties for Activist Shareholders*, 60 STAN. L. REV. 1255, 1258 (2008).

[27] Strine Dangers, at 792.

[28] *See* Benoit, *supra* note 18.

[29] John C. Coffee, Jr. & Darius Palia, *The Wolf at the Door: The Impact of Hedge Fund Activism on Corporate Governance*, 41 IOWA J. CORP. L. 545, 551 (2016); Leo E. Strine Jr., *One Fundamental Corporate Governance Question We Face: Can Corporations Be Managed for the Long Term Unless Their Powerful Electorates Also Act and Think Long Term?*, 66 BUS. LAW. 1, 10, 14-16 (2010) [hereinafter Strine 2010].

[30] Seth C. Oranburg, *A Little Birdie Said: How Twitter is Disrupting Shareholder Activism*, 20 FORDHAM J. CORP. & FIN. L. 695, 706 (2015) (noting that activist investor Carl Icahn's Twitter posts have had significant impact on companies' stock prices).

[31] The SEC issued a report in 2013 ("SEC Report") making it clear that companies can use social media outlets to announce key information in compliance with Regulation Fair Disclosure ("Regulation FD") as long as investors have been alerted about which social media will be used to disseminate such information. U.S. SEC. & EXCH. COMM'N, SEC. AND EXCH. ACT OF 1934 RELEASE NO. 69,279, REPORT OF INVESTIGATION PURSUANT TO SECTION 21(A) OF THE SECURITIES EXCHANGE ACT OF 1934: NETFLIX, INC., AND REED HASTINGS (Apr. 2, 2013), *available at* https://www.sec.gov/litigation/investreport/34-69279.pdf. The SEC Report clarified that company communications made through social media channels could constitute selective disclosures and, therefore, require careful analysis under Regulation FD. *Id*. Regulation FD requires companies to distribute material information in a manner reasonably designed to get that information out to the general public broadly and non-exclusively. *Id.* It is intended to ensure that all investors have the ability to gain access to material information at the same time. *Id.*

to make thoughtful decisions.[32] Several of the Fellows noted that some corporations are learning that they must be prepared to use these new channels of communication.[33] They are positioning the corporations and their strategies in a manner that allows investors to better understand the corporations' priorities.[34]

Marketplace demands for short-term results often conflict with the long-term interests of the corporation.[35] For example, these demands may lead corporations to use measures such as staffing reductions, decreases in research and development expenditures, and changes in accounting practices to improve a firm's short-term financial reporting position at the expense of long-term profits.[36]

The Fellows also noted that much of the academic research on corporate governance and shareholder issues is supported and funded by activist investors and the plaintiff's bar.[37] As a result, the published

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[32] *See* Leo E. Strine Jr., *Making it Easier for Directors to "Do The Right Thing"?,* 4 HARV. BUS. L. REV. 235, 241-42 (2014) [hereinafter Strine Making it Easier] (noting that technological advances have made corporate boards more accountable to stockholders); Leo 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, 473 (2014) [hereinafter Strine Do Better] (noting that internet communications have contributed to making corporations vulnerable to takeovers).

[33] *See* ABA Report, at 132 ("Companies also are experimenting with shareholder surveys and web-based communications as a means of obtaining insights on shareholders' concerns.").

[34] *See* Leo E. Strine Jr. & Nicholas Walter, *Conservative Collision Course?: The Tension Between Conservative Corporate Law Theory and Citizens United,* 100 CORNELL L. REV. 335, 369 (2015) (citing corporations' increased accountability to shareholders).

[35] *See* Martin Lipton & William Savitt, *The Many Myths of Lucian Bebchuk*, 93 VA. L. REV. 733, 745-46 (2007) [hereinafter Lipton & Savitt]; s*ee also* H. Rodgin Cohen, Glen T. Schleyer, *Shareholder vs. Director Control Over Social Policy Matters: Conflicting Trends in Corporate Governance*, 26 NOTRE DAME J.L. ETHICS & PUB. POL'Y 81, 88-89 (2012) [hereinafter Cohen & Schleyer] (noting that balancing long-term interests of shareholders, including broad societal interests, with short-term economic and competitive incentives is a difficult task, and one that the Board is uniquely qualified to undertake).

[36] *See* Martin Lipton & Paul K. Rowe, *The Inconvenient Truth about Corporate Governance: Some Thoughts on Vice-Chancellor Strine's Essay*, 33 J. CORP. L. 63, 63-64 (2007) [hereinafter Lipton & Rowe]; Dallas & Barry, *supra* note 72, at 563 (finding that companies that engage in earnings management do so at the risk of long-term value); John F. Olson, *Reflections on a Visit to Leo Strine's Peaceable Kingdom,* 33 J. CORP. L. 73, 75 (2007) [hereinafter Olson 2007] (noting that a 2004 study found that 78% of CFOs surveyed "would sacrifice a profitable long-term project if taking on the project would cause them to miss their short-term earnings targets"); *see also* Strine 2010, at 2 ("I believe that the generation of durable wealth for its stockholders through fundamentally sound economic activity, such as the sale of useful products and services, is the primary goal of the for-profit corporation.").

[37] *See* Paul Rose, *The Corporate Governance Industry*, 32 J. CORP. L. 887, 900 (2007); Lipton & Rowe, at 69 ("The professorial wing of the corporate governance lobby has given intellectual cover to the for-profit advisers and the activist hedge funds, by appearing to lack their economic motives. Throughout the last two decades, these academics have produced a

research in the area of corporate governance and shareholder issues is at risk of being skewed, and it is difficult for corporate Boards to find statistical support for their sides of various arguments.[38]

There are signs of greater focus on the long-term.[39] Long-term investors such as pension funds prioritize sustainability in their investment decisions.[40] Demographic changes were also discussed by the Fellows, with reference in particular to the millennial generation focusing on social issues.[41] Fellows discussed whether Boards should consider the interests of stakeholders other than shareholders.[42] Some of the Fellows stated that Boards should be able to consider other interests when making decisions, such as the impact on communities, employees, and the environment.[43]

B. *Increased Influence of Shareholders on Corporate Decisions*

The Fellows focused much of their discussion on the impact of increased shareholder influence on corporate decision making. Many spoke to the benefits of increased shareholder engagement.[44] The resulting dialogue between corporations and their investors is positive.[45] Boards and management have more opportunity to explain the strategic considerations and to explain the reasons for their decisions.[46] This heightened accountability has also caused directors to be more engaged

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seemingly endless series of articles that purport to quantify and provide empirical support for the governance agenda devised by the for-profit advisers.").

[38] Lipton & Rowe, at 70.

[39] *See* Olson 2007, at 79-80 (discussing the growing support for a move away from short-termism).

[40] *See* Strine Do Better, *supra* note 4, at 481 n.95.

[41] 2015 Cone Communications Millenial CSR Study, CONE COMM, http://www.conecomm.com/research-blog/2015-cone-communications-millennial-csr-study#download-research (last visited Dec. 8, 2015) (indicating that millennials are drawn to socially conscious companies).

[42] *See* Revlon, Inc. v. MacAndrews & Forbes Holdings, 506 A.2d 173, 176 (Del. 1986) (stating that in combatting short-termism, the ability of corporate Boards to consider non-stockholder stakeholders is limited to instances where such consideration is "rationally related [to] benefits accruing to the stockholders.").

[43] Delaware recently amended its general corporation law to include Public Benefit Corporations. *See* 8 Del. C. § 362 (2013).

[44] ABA Report, at 112 ("Shareholders and boards have become increasingly engaged in their roles, and generally this increased engagement has been a positive development.").

[45] *Id.*

[46] Lisa M. Fairfax, *Mandating Board-Shareholder Engagement?,* U. ILL. L. REV. 821, 833 (2013) ("[E]nhanced shareholder engagement gives corporations the ability to educate their shareholder base. Such engagement provides corporations with the opportunities to explain their perspectives and policies in a manner that could prevent misunderstandings.").

and to ask good questions, and it has led to positive procedural changes such as executive sessions of non-management directors.[47] There was a general view that aggressive stockholder activism will continue, due largely to the super-normal returns that some activist funds are producing.[48] While disruptive and often focused on short-term gains over long-term sustainability, activism was not viewed as a categorically bad thing for corporate governance. In light of the threat of activism, directors are holding themselves and their fellow directors to higher standards.[49] Some of the Fellows stated that Boards should be able to consider other interests when making decisions, such as the impact on communities, employees, and the environment.[50]

The Board is a lightning rod for activist criticism. The ability of activists to garner support for short-term actions (such as dividends and major transactions) puts pressure on Boards to consider these alternatives, even when they are not aligned with the corporation's strategy.[51] Fellows noted the dangers inherent in substituting activist priorities for actions that the Board and management believe are in the best interests of the corporation.[52] Fellows noted investors do not have the information and experience that would enable them to govern a corporation as well as a properly-appointed Board.[53] It was also noted that investor influence is often exercised, not by ultimate beneficial owners, but by intermediaries in the chain of share ownership, whose objectives do not necessarily coincide with the best interests of the

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[47]*See* ABA Report, at 129-33.

[48]*See* Frederick H. Alexander & James D. Honaker, *Power to the Franchise or the Fiduciaries? An Analysis of the Limits of Stockholder Activist Bylaws*, 33 DEL. J. CORP. L. 749, 769 (2008) [hereinafter Alexander & Honaker] ("Stockholder activists will certainly continue to test the limits of Delaware law with bylaw proposals that curtail [Board] authority."); Victor I. Lewkow, Alan L. Beller, Janet L. Fisher, Ethan A. Klingsberg, *Board Focus 2012,* 2012 BUS. L. TODAY 1, 2 (2012) ("Studies have shown hedge fund activists to be highly effective at inducing increases in leverage, share buybacks, and dividends.").

[49]Cohen & Schleyer, at 113 (indicating the Board's role in limiting "the effects of corporate misbehavior").

[50]*See* Cohen & Schleyer, at 116 (opining that Delaware law will likely condone most socially conscious stakeholder investments as reasonably related to stockholder benefit); b*ut see* GREGORY V. VARALLO, DANIEL A. DREISBACH & BLAKE ROHRBACHER, FUNDAMENTALS OF CORPORATE GOVERNANCE: A GUIDE FOR DIRECTORS AND CORPORATE COUNSEL, 2ND EDITION 6-7 (2009) (indicating the potential liability for directors who invest in stakeholder interests "at the expense of stockholder's interests").

[51]*See* Olson 2007, at 75 ("[C]ompetition among professional investment management groups creates an emphasis on short-term gains that can threaten the long-term health of the company.").

[52]Olson 2007, at 76 (noting that some empirical studies suggest that shareholder activism and proxy proposals have an insignificant effect on targeted firms' performance – with some finding significant negative impacts resulting from activism).

[53]*See* Cohen & Schleyer, at 88-89, 137.

ultimate investors they are supposed to represent. This is discussed in the next subsection.[54]

Fellows noted that shareholders do not have monolithic interests.[55] Their separate interests are often at odds with one another, especially in an activist context.[56] There are a number of factors that influence shareholder decisions. As outlined by Mr. Sonsini, institutional investors range in size and have different investment time horizons, investment strategies, holding periods, and levels of active engagement with the companies they own.[57] In addition, passive investments such as exchange-traded funds and index funds are on the rise.[58] Taken together, these factors create pressure for high immediate investment returns.[59] As a result, investment managers increasingly focus on short-term results and use short-term investment strategies designed to beat benchmark indexes, while the interests of human investors are generally aligned with long-term growth.[60] Simply put, the concern shared by the Fellows is that investment managers and other intermediaries are not always fulfilling their role as active owners.[61] Large index managers, such as Vanguard, Blackrock, and State Street are acutely aware of this issue and are responding by trying to be "passive investors but active owners."[62]

There was some discussion of the implications of the interests of a shareholder not being aligned with the interests of the corporation.[63] Fellows noted the incidence of negative voting and empty voting as an example of misalignments between voting and economic interests that distorts the corporate model and impacts shareholders' confidence.[64]

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[54] *See infra* Subsection 3(c).

[55] ABA Report, at 140.

[56] *Id.* at 141 (noting that different types of institutional investors have different, sometimes divergent goals).

[57] *See* Sonsini Address.

[58] *See* Strine Do Better, at 481 ("As Americans are forced, as a matter of reality, to give their money to mutual fund complexes to save for retirement, the percentage of the voting power held by index funds will continue to grow.").

[59] *See* Strine 2010, at 10-12.

[60] *Id.*

[61] *See* Olson 2007, at 76 ("The failure of these intermediaries to relate in an effective, value enhancing way to corporate managers creates real economic risk. Even those funds that actively engage in pressure on management decision-making arguably have done little to increase company value."); Strine 2006, at 1765 (noting the tendency of money managers to rely on proxy advisory services).

[62] *Reinventing the deal*, THE ECONOMIST (Oct. 24, 2015), http://www.economist.com/news/briefing/21676760-americas-startups-are-changing-what-it-means-own-company-reinventing-deal.

[63] Strine Making it Easier, at 251 (discussing benefit corporations).

[64] *See* Lipton & Savitt, at 757 n.87.

Others noted situations in which a company amasses shares in a competitor and makes a demand for records.[65]

Some jurisdictions have introduced proposals to reward long-term shareholders with additional voting rights, tax incentives, loyalty dividends, or loyalty shares.[66] Fellows noted that some of these proposals have been criticized by companies as well as shareholders for being overly protectionist and deviating from the one share one vote principle.[67] Some Fellows also raised the example of required holding periods for proxy access proposals as another way to favor shareholders with a long-term perspective on the company.[68] A more radical solution to the conflict issue could be to impose fiduciary duties on investors (*i.e.*, as an owner of the business, you have a duty to act in the best interest of the business).[69] The opportunity to participate in the profits of the corporation as shareholder would be accompanied by an obligation to exercise shareholder rights in the best interest of the institution.[70] While this may seem extreme, Delaware courts have held that liability for breach of fiduciary duty extends to shareholders who effectively control the corporation.[71]

The Fellows also noted that proposals supported by activist investors and large institutional shareholders, such as proxy access

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[65]Alexander & Honaker, at 766-67.

[66]*See generally* Belinfanti, *supra* note 128.

[67]Emeka Duruigbo, *Tackling Shareholder Short-Termism and Managerial Myopia,* 100 KY. L.J. 531, 556-67, 565-66 (2011-2012).

[68]For example, Fellows referred to the Boardroom Accountability Project initiative. SCOTT M. STRINGER, BOARDROOM ACCOUNTABILITY PROJECT (2014), *available at* http://comptroller.nyc.gov/boardroom-accountability/, *archived at* https://perma.cc/LCQ2-F45B (indicating that 75 proxy access stockholder proposals were filed to request bylaw amendments to give stockholders who meet ownership and temporal thresholds the right to list director candidates, representing up to 25 percent of the Board).

[69]Strine 2006, at 1783 ("Rather than continue to focus exclusively on the fiduciary duties of managers of operating companies, reform advocates like Bebchuk might be well advised to look hard at those fiduciaries who directly hold the capital of most Americans – the fiduciaries who run mutual and pension funds."); Alexander & Honaker, at 768 n.65 ("[T]wo commentators have recently suggested that stockholders should be subject to a limited fiduciary duty of loyalty that would be triggered 'whenever a shareholder successfully employs its shareholder status to promote a corporate action that gives it a personal, material economic benefit to the detriment or exclusion of other shareholders.'").

[70]Note that managers of investment funds already owe a fiduciary duty to their constituents "to take steps to increase the value of the funds they manage." Leo E. Strine Jr., *Human Freedom and Two Friedmen: Musings on the Implications of Globalization for the Effective Regulation of Corporate Behaviour,* 58 U. TORONTO L.J. 241, 262 (2008). The "radical solution" discussed here would be to owe this fiduciary duty to each corporation included in the fund.

[71]*See* In re Ezcorp Inc. Consulting Agreement Derivative Litigation, 2016 WL 301245, at *9 (Del. Ch. Jan. 25, 2016).

proposals, are being adopted by more and more companies[72] and this is likely to continue.[73] Some speculated that proxy access would quiet activist investors and noted that such proposals effectively give the activist investors and large institutional shareholders some of what they have been seeking, which is a hard-wired mechanism for access – and that threat/opportunity to act will cause them to be generally less active.[74] Those who thought that the increasing use of proxy access would lead to more activity by such investors noted that these investors will use all tools available to them, and that once a firm process was put in place they would take full advantage of the opportunities presented by such processes.[75] In any event, the participants agreed that proxy access was contributing to more "noise" for corporate Boards and that the current state of play in regards to proxy access was a good example of Boards and investors not listening to each other.

Fiduciary duty was also discussed. There was some concern expressed that Delaware courts put too much emphasis on shareholder interests without necessarily clearly defining what is meant by those interests.[76] The general consensus was that the focus should be on the "long-term health of the enterprise," which is effectively a proxy for the interests of long-term investors. Participants agreed that directors are not "representatives" or "agents" of shareholders.

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[72] *See* Strine Do Better, at 470 n.66 (citing the impact of shareholder proposals).

[73] Alexander & Honaker, at 769 ("Stockholder activists will certainly continue to test the limits of Delaware law with bylaw proposals that curtail [Board] authority.")

[74] Lisa M. Fairfax, *Delaware's New Proxy Access: Much Ado About Nothing?* 11 TRANSACTIONS TENN. J. BUS. L. 87, 93 (2009) ("[A]dvocates of proxy access as well as the SEC contend that such access gives shareholders the ability to participate more fully in the nomination and director process, thereby protecting their fundamental voting right. Advocates further maintain that 'the presence of shareholder-nominated directors would make [Boards] more accountable to the shareholders who own the company and that this accountability would improve corporate governance and make companies more responsive to shareholder concerns'").

[75] *See* Paul Rose, *Regulating Risk By "Strengthening Corporate Governance"*, 17 CONN. INS. L.J. 1, 19 (2010) (noting that proxy access could be harmful to both stockholders and corporations); Cohen & Schleyer, at 128 (recognizing that proxy access may lead to more contested elections); s*ee also* Leo E. Strine Jr., *Toward Common Sense and Common Ground? Reflections on the Shared Interests of Managers and Labor in a More Rational System of Corporate Governance*, 33 J. CORP. L. 1, 14 (2007) [hereinafter Strine 2007] ("At some point, the mantra of 'more, more, more' reform has to stop. If executive pay, takeovers, and elections have all been addressed in a way that creates greater accountability, will institutional investors back off on precatory proposals? On the withhold vote?").

[76] *See supra* note 51.

C. *The Double-Agency Problem*

Many Fellows commented that there is a need to review the governance of institutional investors. As Chief Justice Strine has noted, a significant amount of money is invested on behalf of investors who do not control how the shares bought on their behalf are traded or voted.[77]

The Kay Review in the United Kingdom (the "UK") found that the principal issues in the investment industry are the decline of trust relationships and the misalignment of incentives throughout the investment chain.[78] In the context of investment, trust implies transparency and stewardship. In the UK, major institutions are required to "comply or explain" their principles of engagement under the UK's Stewardship Code.[79] The International Corporate Governance Network ("ICGN") has also begun a consultation process to develop a Global Stewardship Code to complement codes in different markets around the world.[80] Other examples raised to promote trust and transparency include large asset owners and managers publishing their voting policies and disclosing their intentions prior to casting their votes.[81] Some Fellows also noted that compensation incentives for investment managers may not be aligned with the interests of the ultimate investors.[82] For example, compensation structures such as a 2% management fee and a 20% annual performance fee may not promote long-term performance and forward-looking behaviors.[83]

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[77] *See, e.g.* Strine 2007, at 4-5 (describing a system of forced capitalism); Leo E. Strine Jr., *Breaking the Corporate Governance Logjam in Washington: Some Constructive Thoughts on a Responsible Path Forward*, 63 BUS. LAW. 1079, 1082-83 (2008) [hereinafter Strine Logjam].

[78] JOHN KAY, THE KAY REVIEW OF UK EQUITY MARKETS AND LONG-TERM DECISION MAKING FINAL REPORT (July 2012), *available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/253454/bis-12-917-kay-review-of-equity-markets-final-report.pdf.*

[79] FINANCIAL REPORTING COUNCIL, THE UK STEWARDSHIP CODE (Sept. 2012), *available at https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Stewardship-Code-September-2012.pdf.*

[80] INTERNATIONAL CORPORATE GOVERNANCE NETWORK, ICGN GLOBAL STEWARDSHIP CODE MEMBER CONSULTATION (Nov. 2015), *available at https://www.icgn.org/sites/default/files/ICGN%20Global%20Stewardship%20Code%20Consultation%20FINAL%20November%202016.pdf.*

[81] *See* Christopher M. Bruner, *Corporate Governance Reform in a Time of Crisis,* 36 J. CORP. L. 309, 319 (2011) (discussing the UK Stewardship Code).

[82] Strine 2007, at 5 ("These funds are under pressure to generate short-term results, in no small measure because their investors only entrust their capital for some discrete number of years and because the managers take gobs of compensation up-front from the capital they deploy for their investors.").

[83] *See Grassley and Levin introduce hedge fund transparency bill*, CHUCK GRASSLEY, UNITED STATES SENATOR FOR IOWA (Jan 29, 2009),

D. *The Influence of Proxy Advisory Firms*

As Mr. Lipton explained in his article, proxy advisory firms have gained influence because institutional investors can fulfill regulatory requirements by voting in accordance with their recommendations.[84] Larger institutional shareholders with in-house resources use their services as benchmarks, but others lack the resources to do this.[85] Therefore, many investors rely too heavily on their recommendations, which may not be tailored to the context in which specific corporations operate.[86]

A study conducted by the Conference Board, NASDAQ, and the Rock Center for Corporate Governance at Stanford University concluded that proxy advisory firms are an important influence on executive compensation plan design.[87] The study found that over 70% of directors and executive officers reported that their compensation programs were influenced by the guidance or policies of proxy advisory firms.[88] Some Fellows commented that disregarding proxy advisory firms' recommendations carries tremendous risk—and that the consequences have grown more severe with the adoption of majority voting standards and policies.[89] This encourages Boards to govern based on the guidelines and voting recommendations of proxy advisory firms rather than on the Boards' own considered business judgment.[90] The manner in which proxy advisory firms formulate their voting guidelines and make their recommendations leads to a check-the-box approach to corporate governance, which does not necessarily promote shareholder value in

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http://www.grassley.senate.gov/news/news-releases/grassley-and-levin-introduce-hedge-fund-transparency-bill (discussing the proposed Hedge Fund Transparency Act of 2009).

[84] Lipton Mem., at 6.

[85] Olson 2007, at 77-78 ("[M]ost large institutional investors surveyed by the [General Accountability Office] reported that they vote their proxies based on their own diligence or their own corporate rating policies, rather than those formulated by the proxy advisory agency."); Strine Do Better, at 479 ("At smaller mutual fund complexes, voting is more likely to be influenced by outside proxy advisory firms, such as ISS.").

[86] *See* Strine Do Better, at 487-88 (linking proxy advisors' recommendations to stockholder votes).

[87] *See* David F. Larker, Allan L. McCall, and Brian Tayan, *The Influence of Proxy Advisory Firm Voting Recommendations on Say-on-Pay Votes and Executive Compensation Decisions*, THE CONFERENCE BOARD (March 2012), https://www.conference-board.org/retrievefile.cfm?filename=TCB-DN-V4N5-12.pdf&type=subsite; s*ee also* Strine, Can We Do Better, *supra* note 4, at 488 ("[T]he most influential explanatory factor for the outcome of say on pay votes is the recommendation made by the most influential proxy advisory firm . . . .").

[88] *See* Larker et al., *supra* note 87.

[89] Cohen & Schleyer, at 82, 126.

[90] *Id*. at 127 (noting the potential conflict of interests for directors).

every case.[91] Fellows agreed that this "checklist mentality" for Board governance does not promote sustainable value.[92]

The Fellows discussed the imbalance that results from Boards having little opportunity, if any, to effectively engage with proxy advisory firms. Many felt that a vacuum of engagement among proxy advisory firms and corporate Boards existed and that, even if there were more opportunities for corporate Boards to engage with proxy advisory firms, most corporate Boards do not have the "clout" and/or resources for such engagements to be effective or meaningful. Moreover, the small number of corporate Boards that may actually have such "clout" and resources for such engagement is not sufficient to act as a voice for all public companies (nor would they be able to adequately represent all relevant interests of corporate Boards).

Fellows emphasized the need to not focus simply on winning over proxy advisory firms. Instead, Boards should seek to build long-term relationships with their largest shareholders, rather than with the "market" and its agents.[93] Many Fellows also believe the SEC should take a more active role in overseeing proxy advisory firms by regulating the management of conflicts of interests and the procedures for making vote recommendations.[94] For example, ISS faces its own conflicts of interest, given that it runs both a consulting business (directed to companies) and a proxy advisory business (directed to institutional investors).[95]

E. *Board Issues*

The Fellows discussed a wide range of issues relating to the evolution of Board composition and practices. As a general matter, Fellows agreed that there have been many positive developments: board members are more engaged, procedural changes (including executive sessions) contribute to frank discussion among non-management

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[91]Strine 2010, at 24-25 (nothing the inefficiency of check-the-box governance).

[92]*Id.*; Rose, *supra* note 37, at 891 (noting that "governance firms may be overstepping their expertise[.]).

[93]*See* Memorandum of Ira M. Millstein et al., *Meetings Between Directors and Institutional Investors on Governance Matters Are a Constructive Step* (Jun. 29, 2007) (stating that "[c]ompanies have an interest in moving their relationships with large shareholders . . . to a positive and constructive tone").

[94]*See, e.g.,* Strine Do Better, at 499 (opining that stockholder interests would be better served if institutional investors were to tailor voting policies to the "investment horizons of their investors").

[95]Rose, *supra* note 37, at 906 ("ISS is providing both governance ratings and advice on how to improve the governance score – the governance adviser administrating the test will also provide the answer key to those willing to purchase it.").

directors, and the role of the general counsel plays a more central role in the governance of most corporations.[96]

Many noted that Boards are becoming more diverse.[97] The old-style Boards composed of individuals friendly to the CEO are being replaced with Boards composed of true independents.[98] While the change has been incremental rather than dramatic, it has been consistent.[99] Fellows commented that this development has had a positive influence on business.[100] Newcomers to Boards bring a fresh perspective and often challenge longstanding assumptions.[101]

Despite the benefit of new voices on Boards, Fellows did not view mandatory retirement ages or term limits as necessary or advisable.[102] In the view of many of the Fellows, regular review of Board composition and director contribution leads to higher-performing Boards, without sacrificing valuable Board members to arbitrary rules.[103] Fellows generally agreed that focus on diversity among the Board members and

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[96]*See* ABA Report, at 112 (stating that boards' increased engagement in corporate affairs has been positive); Cohen & Schleyer, at 97 (discussing NYSE rules regarding executive sessions); E. NORMAN VEASEY & CHRISTINE T. DI GUGLIELMO, INDISPENSABLE COUNSEL 45 (2012) (discussing the role of general counsel).

[97]Cohen & Schleyer, at 103 (citing SEC rule changes regarding board diversity).

[98]Lipton & Savitt, at 753 ("[D]irectors are now selected by a nominating committee of independent directors and not by a [CEO], with the result that boards are much less beholden to their CEOs, and much more susceptible to outside pressure, than ever before.") (internal citations omitted); Strine 2010, at 24 ("[T]here is little doubt that corporate boards are working harder than ever and are comprised more than ever of individuals whose independence cannot be doubted.").

[99]Strine 2006, at 1767 (discussing the trend towards powerful independent directors).

[100]*See* Sandeep Gopalan & Katherine Watson, *An Agency Theoretical Approach to Corporate Board Diversity,* 52 SAN DIEGO L. REV. 1, 8 (2015) (citing a report suggesting the diverse boards lead with higher returns on equity, sales, and invested capital); Michael Adams, *Board Diversity: More Than a Gender Issue?,* 20 DEAKIN L. REV. 123, 138 (2015) (noting a link between board diversity and corporate performance in Australian companies), *but see* Deborah L. Rhode & Amanda K. Packel, *Diversity on Corporate Boards: How Much Difference does Difference Make?,* 39 DEL. J. CORP. L. 377, 390 (2014) ("In sum, the empirical research on the effect of [Board] diversity on firm performance is inconclusive, and the results are highly dependent on methodology.").

[101]*See* Joan MacLeod Heminway, *Women in the Crowd of Corporate Directors: Following, Walking Alone, or Meaningfully Contributing,* 21 WM. & MARY J. WOMEN & L. 59, 82 (2014) (noting the benefit of women decision-makers on the effectiveness of corporate boards).

[102]Rose, *supra* note 37, at 902 (noting the lack of a link between age or term limits and financial performance or corporate risk).

[103] INSTITUTE OF CORPORATE DIRECTORS, BEYOND TERM LIMITS: USING PERFORMANCE MANAGEMENT TO GUIDE BOARD RENEWAL 8 (Jan 28, 2015), *available at https://www.icd.ca/getmedia/e57f3478-2b5c-4f14-aad4-5aa8d6a7298d/15-1889-Beyond_Term_Limits_EN_Final.pdf.aspx* (stating that "performance management" rather than adherence to arbitrary rules governing board turn-over is more beneficial).

executives will continue to grow since corporations are still falling short of having a diverse boardroom or c-suite.[104]

Fellows noted that search firms need to contribute to addressing this issue—they often present the same list of the same individuals when corporations are looking for new Board members and executives.[105] The efforts of one search firm in particular were discussed; that firm presents companies with a diverse list as a matter of course—that used to not be the case and is viewed as a positive change. Fellows expect to see more changes as focus on diversity continues to increase.[106] Fellows also discussed the meaning of "diversity."[107] Some felt that first and foremost the focus should be on gender diversity, in part because other types of diversity (such as ethnic diversity) are much broader, while others preferred consideration of all types of diversity.[108]

Fellows also discussed the need to focus on the quality and the timeliness of the information provided to the Board.[109] General counsel, together with outside counsel, can play a significant role in ensuring that Boards receive information in an appropriate form and in a timely manner.[110] The manner in which the information is presented is important. Consideration should be give, for example, to whether a narrative executive summary would be more useful than a 150-page slide deck filled with dense graphs and charts.[111]

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[104]Rhode & Packel, *supra* note 100, at 379 (noting that as of 2013, almost 75% of corporate Boards of the Fortune 500 were white men, and as of 2014 women held only 16.9% of the seats on Fortune 500 Boards).

[105]*But see* Kimberly D. Krawiec, John M. Conley & Lissa L. Broome, *The Danger of Difference: Tensions in Directors' View of Corporate Board Diversity,* 2013 U. ILL. L. REV. 919, 952 (2013) (indicating that the use of search firms is limited, as the board selection process is largely a matter of personal networks).

[106]Lisa M. Fairfax, *Board Diversity Revisited: New Rationale, Same Old Story?,* 89 N. C. L. REV. 855, 864 (2011).

[107]*Id.* at 874-75 (noting the the SEC diversity disclosure rule fails to define diversity).

[108]*See* Rhode & Packel, *supra* note 100, at 383 (noting the focus on gender diversity); Justin Blount, *Creating a Stakeholder Democracy under Existing Corporate Law,* 18 U. PA. J. BUS. L. 365, 408 (2016) (stating that the diversity of board members should reflect the diversity of investors).

[109]*See* ABA Report, at 124 (discussing the obligation of directors to become timely informed); In re Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 970 (Del. Ch. 1996) (discussing the duty of oversight); Smith v. Van Gorkom, 488 A.2d 858, 874 (Del. 1985) (discussing the relationship between becoming informed and exercising business judgment).

[110]E. Norman Veasey, *Corporate Governance and Ethics in the Post-Enron Worldcom Environment,* 38 WAKE FOREST L. REV. 839, 852 (2003) (indicating that utility of assistance from general and outside counsel); *see* DEL. CODE ANN. tit. 8 § 141(e) (1998) (Noting that directors are "fully protected in relying in good faith upon the records of the corporation and upon such information, opinions, reports or statements presented to the corporation by any of the corporation's officers or employees . . . .").

[111]*See* Nicola Faith Sharpe, *Questioning Authority: The Critical Link Between Board Power and Process,* 38 J. CORP. L. 1, 24 (2012) (discussing boards' obligation to engage with

There was some discussion about whether mandating the separation of Chair of the Board and CEO would improve governance of US corporations.[112] Some Fellows felt that the separation of these positions contributes to greater independence in the Board's oversight of management.[113] However, other participants questioned whether mandating the separation of these positions would remove the flexibility of Boards to make determinations based on unique facts and circumstances.[114] Fellows noted that Canada has achieved this separation through an evolution of market practice, not because of a mandate.[115] In addition, Fellows pointed out that an active and involved lead director and regular executive sessions of non-management directors are also an effective means of promoting active oversight of the corporation's business and affairs.[116]

Fellows also discussed the extent to which personal liability is a concern for directors. Several Fellows referred to recent opinions issued by the Delaware courts that highlight the difficulty that plaintiffs face in obtaining a judgment holding directors personally liable for breach of

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the relevant information before acting, however poorly the information is presented); *but see* Mary Jo White, Speech to the National Association of Corporate Directors Leadership Conference 2013 (Oct 15, 2013), *available at* https://www.sec.gov/News/Speech/Detail/Speech/1370539878806#.UnJ1N_lJOhN (stating that too much disclosure could lead to a harmful "information overload").

[112] 48 Stat. 881, 15 U.S.C. § 78n-2 (comply-or-explain requirement enacted through Dodd-Frank § 972 requiring disclosure showing why the Chair of the Board / CEO positions are held by the same or different people).

[113] *See* S.E.C. v. Worldcom, Inc., 2003 WL 22004827, at *34 (S.D.N.Y. Aug. 26, 2003) (discussing the advantages of having a non-executive chairman of the board); Sharpe, *supra* note 111, at 20 (noting the regulatory benefit of different people serve as chairman and CEO); *see also* SPENCER STUART, 2015 SPENCER STUART BOARD INDEX 20 (Nov 17, 2015), https://www.nyse.com/publicdocs/Spencer_Stuart_Board_Index_2015.pdf (noting that during the past decade, separating the Chair of the Board and CEO positions in S&P 500 boards has increased from 29% in 2005 to 48% in 2015).

[114] Paul Rose, *Regulating Risk By "Strengthening Corporate Governance"*, 17 CONN. INS. L.J. 1, 20-21 (2010) (stating that the comply-or-explain provision of Dodd-Frank leads to the inefficient separation of chairman and CEO); *see* Dawn Kopecki & Hugh Son, *JPMorgan Shareholders Reject Splitting CEO Dimon's Dual Roles,* BLOOMBERG (May 22, 2013), http://www.bloomberg.com/news/articles/2013-05-21/victory-for-dimon-as-jpmorgan-shareholders-reject-ceo-chairman-split.

[115] *See* CLARKSON CENTRE FOR BOARD EFFECTIVENESS, CEO/CHAIR STRUCTURE IN CANADA COMPARED TO THE U.S. IN 2013 1 (Jan. 2014), http://www.rotman.utoronto.ca/-/media/Files/Programs-and-Areas/Institutes/Clarkson/CEO_CHAIR-Structure-in-Canada-compared-to-US-CCBE_Spizzirri.pdf?la=en (noting that a 2013 survey found "84% of [S&P / Toronto Stock Exchange Composite Index] issuers had a CEO/Chair split.").

[116] *See* Z. Jill Barclift, *Governance in the Public Corporation of the Future: The Battle for Control of Corporate Governance,* 15 CHAP. L. REV. 1, 14 (2011).

fiduciary duty.[117] For example, claims against individual directors in mergers and acquisitions litigation were dismissed at an early stage of the proceeding, due to the presence of provisions of the certificate of incorporation exculpating them against monetary damages for personal liability, while the Board's financial advisors remained in the case as defendants in connection with plaintiffs' claims for aiding and abetting the directors' breach of the duty of care.[118] Many noted that the threat of personal liability is not the only factor motivating director conduct.[119] If anything, directors have become more serious about their roles in managing and directing the business and affairs of the corporation.[120] Directors care deeply about their reputations, and the threat of having their conduct criticized in a published opinion, even if they ultimately would not be held personally liable for monetary damages, tends to focus their attention.

Finally, there were discussions about the need for greater awareness of governance issues at the management level.[121] Many governance mistakes have been due to integrity failures further down the management chain that were not adequately addressed. These issues were not in the larger strategic view of corporate governance, but arose in implementation.[122] Supply chain management is a good example. The Board will have less direct involvement in this issue than, for example, in capital allocation decisions, but both are critical from a risk management standpoint.[123] Both demand governance processes that protect the organization.[124]

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[117] *See, e.g.,* In re TIBCO Software Inc. S'holders Litig., 2015 WL 6155894 (Del. Ch. Oct. 20, 2015) [hereinafter *In re* TIBCO]; In re Zale Corporation Stockholders Litigation, 2015 WL 5853693 (Del. Ch. Oct. 1, 2015).

[118] *See, e.g.*, In re TIBCO, *supra* note 197, at *24-25; *see also* 8 Del. C. § 102(b)(7) (1993) (Permitting corporations to include in their certificates of incorporation a provision exculpating directors against monetary damages to the corporation and its stockholders for breaches of the directors' duty of care).

[119] ABA Report, at 126-27 (discussing factors in addition to personal financial liability, including damage to directors' personal reputations, that drive directors' conduct); Lipton & Savitt, at 753-54 (citing personal reputation as directors' largest motivator).

[120] Lipton & Savitt, at 753 (discussing the various mechanism that have lead to increased board engagement).

[121] Ben W. Heineman, Jr., *The Chief Compliance Officer Debate: Focus on Function Not Form,* 2016 BUS. L. TODAY 1, 2 (2016) (discussing the need for an emphasis on compliance and integrity).

[122] *See, e.g.,* Constance E. Bagley, Mark Roellig & Gianmarco Massameno, *Who Let the Lawyers Out?: Reconstructing the Role of the Chief Legal Officer and the Corporate Client in a Globalizing World,* 18 U. PA. J. BUS. L. 419, 425-49 (2016) (discussing integrity failures in Volkswagen, British Petroleum, and GlaxoSmithKline).

[123] Daniel W. Gerber & Brian R. Biggie, *The Global Supply Chain: Understanding, Measuring, Mitigating and Managing Exposure in a Supply Chain Dependent Globalized*

Management governance is especially important in large, multi-national companies. When a company reaches a level of global complexity, there was some concern that it might not be possible for a Board that meets five to eight times per year to effectively govern it.[125] For an example of a governance failure on a multi-national Board, consider *In re Puda Coal, Inc. S'holders Litig.*, in which a Board of a company with substantial operations in China was criticized because no one on the Board had ever been to China or spoke the language.[126]

F. *Role of the Regulators and Legislators*

Fellows discussed the impact on Boards of legislative governance regulations, including those stemming from SOX and Dodd-Frank. The general consensus was that SOX and other regulatory regimes were not imposing undue burdens on Boards or directors or adversely affecting the general functioning and effectiveness of Boards, although serving as a director now involves a significantly greater commitment of time.[127] Overall management and direction of the business is handled at the plenary meetings of the Board, where it more appropriately belongs. Many of the compliance roles have been delegated to committees of the Board charged with overseeing specific roles, including examining enterprise risk, cybersecurity, financial risk, and other matters. While there may have been some initial shock from SOX, most sophisticated Boards have developed policies and procedures to meet its demands.[128] The Board's advisors, including the auditors and outside counsel, serve an important role in ensuring that those procedures are implemented appropriately and that the processes are managed efficiently. The Dodd-

Market, 79 DEF. COUNS. J. 412, 414 (2012) (discussing the need for adequate supply chain management).

[124] *Id.*

[125] Virginia Harper Ho, *Team Production & the Multinational Enterprise,* 38 SEATTLE U.L. REV. 499, 510-11 (2015) (Explains that a multidivisional form of multinational enterprises has emerged in which "central executives were responsible for strategy, resource allocation, and monitoring, while divisions handled operational matters. . . . Each corporate division, unlike a subsidiary, is not a separate legal entity but is instead an operating unit contained within the parent corporation.").

[126] C.A. No. 6476-CS (Del. Ch. Feb. 6, 2013) (TRANSCRIPT).

[127] Olson 2007, at 79 (noting improvement despite significant costs of SOX implementation); Strine 2007, at 14 (noting the time-consuming nature of regulatory compliance).

[128] Robert Prentice, *Sarbanes-Oxley: The Evidence Regarding the Impact of SOX 404,* 29 CARDOZO L. REV. 703, 714, 719-23 (2007) (discussing the benefit of SOX reforms).

Frank governance mandates, primarily related to executive compensation and social issues were criticized by a number of Fellows.[129]

The perspectives of the Fellows on the appropriate role of the SEC in corporate governance moving forward were mixed. Some believed the SEC should take a more active role in improving corporate governance through discipline of proxy advisory firms and other rulemaking initiatives, while others believed that the SEC's role should be to "level the playing field" and remain neutral on these issues.[130] There was general consensus among participants that the universal ballot initiative would be helpful to the proxy voting process.[131] Some Fellows feel that the increasing number of statutory and regulatory corporate governance requirements and practices designated as "best practices" by various governance organizations become a distraction.[132] Layering best practice upon best practice blunts the effect of those practices on a corporation's governance.[133] Finally, Fellows were concerned with pressure on the SEC to incorporate social issues (such as the *Citizens United* controversy) into its agenda.[134]

Fellows noted that Congress has spearheaded many of the developments in corporate governance over the last 20 years.[135] They agreed that many of these developments have had a positive effect, but are wary of the tendency of Congress to seize on particular trends in corporate governance and mandate them with immediate effect. Given the thought devoted to governance at the corporate level and the input from a range of stakeholders, Fellows do not believe that there is need

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[129] *See, e.g.,* Stephen M. Bainbridge, *Dodd-Frank: Quack Federal Corporate Governance Round II,* 95 MINN. L. REV. 1779, 1806-11 (2011); Celia R. Taylor, *Drowning in Disclosure: The Overburdening of the Securities & Exchange Commission,* 8 VA. L. & BUS. REV. 85, 93-97 (2014); Donna M. Nagy, *The Costs of Mandatory Cost-Benefit Analysis in SEC Rulemaking,* 57 ARIZ. L. REV. 129, 143 (2015).

[130] *See* E. Norman Veasey & Christine Di Guglielmo, *History Informs American Corporate Law: The Necessity of Maintaining a Delicate Balance in the Federal "Ecosystem"*, 1 VA. L. & BUS. REV. 201, 205 (2006) (stating that increased federal regulation intrudes on the state law domain over internal affairs).

[131] Andrew A. Schwartz, *Financing Corporate Elections,* 41 J. CORP. L. 863, 875 (discussing universal-ballot proxy voting and its effects); Mary Jo White, Speech at the Society of Corporate Secretaries and Governance Professionals, 69th National Conference (June 25, 2015), *available at https://www.sec.gov/news/speech/building-meaningful-communication-and-engagement-with-shareholde.html* (noting the benefit to shareholders by adoption of universal-ballot procedures).

[132] *See* Lipton & Rowe, at 64, 68.

[133] Strine 2010, at 25 ("There is a limit to the ability to add more to the managerial agenda without compromising management's ability to effectively perform its most important duties.").

[134] Cohen & Schleyer, at 116-24 (discussing the history of the SEC's involvement in social policy proposals through Rule 14a-8).

[135] *See id*. at 85-104 (discussing requirements stemming from SOX and Dodd-Frank).

for further congressional intervention on governance matters at this time.[136]

IV. KEYNOTE ADDRESS[137]

In his keynote address, Chief Justice Strine considered whether the incentive system for the governance of American corporations optimally encourages long-term investment and sustainable policies, and therefore creates long-term economic and social benefit for American workers and investors. He noted that the investment horizon of the ultimate beneficial stockholders – ordinary Americans who are saving to pay for their retirements and their children's education – is long. This horizon is much more aligned to the interests of corporate managers who run businesses than that of the direct stockholders, namely investment managers who are under strong pressure to deliver immediate returns at all times. Chief Justice Strine proposed a specific agenda to address this incentive system and the alignment of interests between the investment horizon to optimally run a business and that of the ordinary investors. He also proposed a policy agenda to promote a sustainable, long-term commitment to economic growth in the US, including reforming approaches to taxation and investment policies to address infrastructure and climate change and to promote the competitiveness of American industry.

In support of his agenda to encourage long-term growth, Chief Justice Strine referred to "*Overcoming Short-Termism: A Call for a More Responsible Approach to Investment and Business Management*[,]*"* a report issued by the Aspen Institute in 2009, in which CEOs, leading corporate lawyers, and non-profit and foundation leaders embraced the principles of creating market incentives to encourage patient capital; clarifying, enhancing, and rigorously enforcing the fiduciary duties of financial intermediaries to better align the interests of the intermediaries and the long-term interests of investors; and giving investors greater and more timely information about the interests of activists who seek to influence corporate policies.[138]

On the topic of corporate governance specifically, Chief Justice Strine noted the problems within the investment chain and outlined three

[136] *See* Strine Logjam, at 1084-85 (discussing a federalism-based argument against federal influence).

[137] *See* Strine Keynote, *supra* note 9.

[138] *See* ASPEN INSTITUTE, OVERCOMING SHORT-TERMISM: A CALL FOR A MORE RESPONSIBLE APPROACH TO INVESTMENT AND BUSINESS MANAGEMENT (Sept. 9, 2009), *available at* http://tinyurl.com/j32x28l.

policy proposals to reform the incentives of and enhance the fiduciary accountability of institutional investors.

First, Chief Justice Strine discussed the need for the most rational investors to think and be heard. He noted that the most rational investors who are best positioned to vote in the long-term interest, index funds, are the least active in the corporate governance debate. Although larger funds have systems in place to make voting decisions, these decisions are made on an issuer-by-issuer basis and may likely be influenced by outside proxy advisory firms. In the past, this has led to index funds voting both yes and no on the same merger. To promote sustained stockholder value, the most rational investors must represent their investors more faithfully in the corporate voting process. Chief Justice Strine describes this as "the need for the now powerful institutional investor community to mature, and to strike a more sensible balance for those they represent." Modest steps in that direction would include:

- requiring index funds to do their own thinking and vote in a manner that is consistent with the investment philosophy of their investors;
- precluding index funds from relying upon proxy advisory firms that do not provide index-specific guidance; and
- requiring mutual funds that accept 401(k) and college saving investments to have voting policies that take into account long-term interests of their investors.

Second, Chief Justice Strine discussed the need to make more appropriate investment opportunities available to investors focused on long-term gains. He noted that most of the investment products offered to 401(k) investors are not well tailored to their investment horizons. The long-term investment approach is more akin to private equity funds and, as such, the private equity industry may be incentivized to develop investment vehicles in which ordinary investors could participate.

Third, Chief Justice Strine discussed the need to reduce the number of votes so that good decisions can be made and unnecessary costs can be avoided. He noted that the present system involves too many votes for the institutional investor community to consider and address thoughtfully. In this respect, if institutional investors continue to be mandated to vote on every proposal, it is important that institutional investors be permitted to vote in a manner consistent with their investors' interests. In this respect, he noted that institutional investors should be permitted to make a considered decision as to when to vote, including the categorical decision that they will not vote on certain types of proposals.

Chief Justice Strine also proposed a number of measures that could relieve some of the pressures that shareholders have been imposing on Boards and allow directors more room to exercise judgment.

These measures included the following:

- a triennial vote on executive compensation;
- a triennial approach to proxy reimbursement at companies without a classified Board, and a by-laws stipulation that proxy reimbursement would only be available to a proxy contestant whose slate achieved victory or a credible percentage of the vote;
- filing requirements that would give the voting electorate more information about the economic interests of activist stockholders proposing to influence and alter corporate business strategies;
- a standard form of poison pill for companies without classified Boards;
- a requirement that fiduciaries under ERISA authorize law suits only after a vote by the fund trustees and a decision that the litigation raises an important economic or corporate governance issue of materiality to the fund and that the costs of litigation are outweighed by the benefits of the litigation to the fund beneficiaries; and
- support for the development of the benefit corporation model, which gives corporate managers the ability to take a more long-term approach to corporate investment that better balances the interests of investors in long-term growth and society in business practices that do not externalize costs to workers, the environment, or consumers.

Chief Justice Strine proposed that these measures would better align all the critical elements of our corporate governance economic system around the common and sensible objective of increasing our national prosperity through fundamentally sound, sustainable approaches to investment and business planning.

As a final comment, Chief Justice Strine stated that the US should commit to an active international agenda to work with partners in the EU and the OECD to globalize the managed form of capitalism that has made their member states both prosperous and socially responsible. Many of the measures he proposed to encourage long-term investment could be a model for other jurisdictions to use in addressing their own concerns about short-termism. However, the US should also call for globalized regulatory standards protecting workers, consumers, and the environment, so as to reduce incentives to send jobs, assets, and operations to jurisdictions with lower standards.

V. THOUGHTS FOR THE FUTURE OF GOVERNANCE

There was a strong consensus during the Colloquium discussions that an organization's governance is a key determinant of whether its business is managed for short-term results or for the creation of sustainable value. There was also broad agreement that in order for governance practices to better support long-term value objectives, the relationships between shareholders (particularly activist shareholders) and Boards must be re-aligned.

Fellows noted that directors can contribute to better alignment with shareholders by using transparency and shareholder engagement to build trust.[139] Many noted the outsized influence of proxy advisory firms on corporate governance practices and recommended clear disclosure and open lines of communications with investors as important tools for companies to counter this influence.[140] Among other things, this will facilitate shareholder understanding and support for governance practices that directors believe are best suited for the organization. Improved dynamics between Boards and shareholders (particularly long term shareholders) can also help companies resist opportunistic attacks on their governance by hedge fund activists.[141] If a company's governance and strategy is well understood by its shareholders, there will be less opportunity for activists to seize the corporate agenda.[142]

Turning to shareholders, Fellows recommended that shareholders understand and accept that they cannot be as informed as the Boards of the corporations in which they invest. In order for a Board to be able to manage the corporation and its business in the interests of all shareholders, the shareholders must be prepared to rely on the directors they elect.[143] It is in the interests of shareholders to invest in building relationships of trust with organizations to which they look for the creation of sustainable value.[144]

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[139] *See* John F. Olson, *Is the Sky Really Falling? Shareholder-Centric Versus Director-Centric Corporate Governance*, 9 TENN. J. BUS. L. 295, 304 (2008); ABA Report, at 150.

[140] *See* Olson, *supra* note 139, at 304.

[141] Strine 2010, at 7 (suggesting that increased dialogue between the board and investors could minimize proxy fights).

[142] Fairfax, *supra* note 46, at 834 (linking shareholder engagement to support of board policies).

[143] *See* Strine 2010, at 2.

[144] Strine 2010, at 8 ("The rights given to stockholders to make proposals and vote on corporate business are premised on the theory that stockholders have an interest in increasing the sustainable profitability of the firm.").