Stockholders vs. Stakeholders

By J. Anthony Terrell

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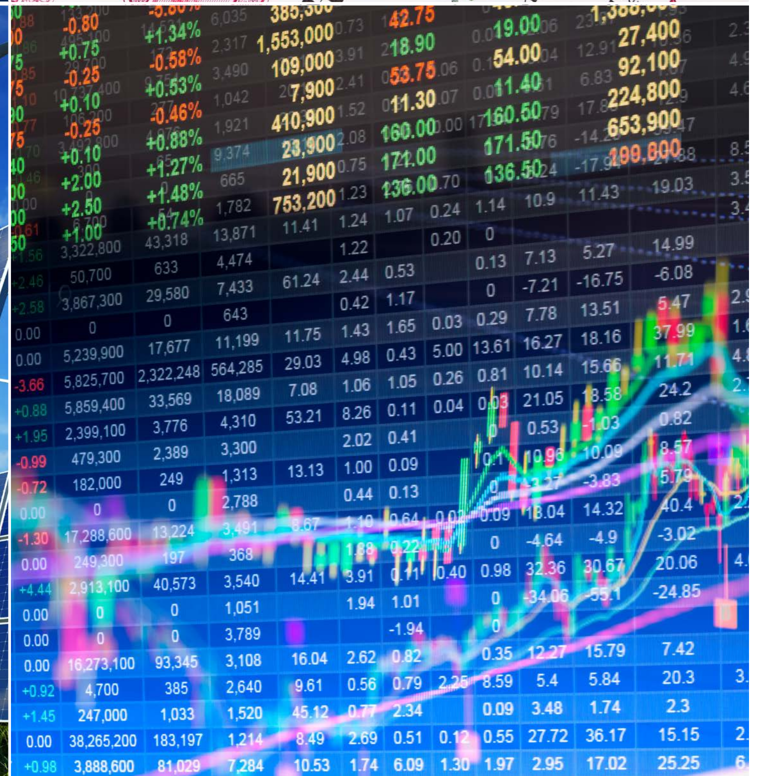

Why did Bill Gates start Microsoft? While corporations can be formed for any number of reasons, it seems safe to assume, in the ordinary case, that a for-profit corporation is formed to found a new business or expand an existing one and that such a corporation, having been set up and funded by the initial stockholders, is operated and managed for the purpose of carrying on that business, presumably with the objective of enhancing its value over time. This would inure ordinarily to the benefit of the stockholders, as indirect owners of the business.

Since the mid-1980s, questions have come up as to whether the directors of a for-profit corporation, in exercising their managerial discretion, may or should consider the interests of stakeholders other than stockholders -- that is, "other constituencies", such as employees, customers, creditors, suppliers, communities and the environment. In the current socio/political environment, further questions arise as to whether or not the directors should be required to consider the interests of such other constituencies or, indeed, especially in the case of public companies, to manage the corporation, at least in part, for the benefit of these other constituencies.

Two eminent legal scholars have written outstanding essays thoroughly discussing all aspects of these questions.

- "For Whom is the Corporation Managed in 2020? The Debate over Corporate Purpose", by Edward B. Rock, Martin Lipton Professor of Law, New York University School of Law, and

- "Restoration: The Role Stakeholder Governance Must Play in Recreating a Fair and Sustainable American Economy – A Reply to Professor Rock", by Leo E. Strine, Jr., Ira M. Millstein Distinguished Senior Fellow at the Ira M. Millstein Center for Global Markets at Columbia Law School; and, among other things, Of Counsel to Wachtell, Lipton, Rosen & Katz and former Chief Justice and Chancellor of the State of Delaware.

Both of these articles, which appear in the Spring 2021 issue of *The Business Lawyer*, published by the Section of Business Law of the American Bar Association, confirm that under current Delaware corporation law:

- in the absence of special circumstances such as the sale of a corporation for cash,
  - the primary objective of the directors is to enhance the long-term value of the corporation for the benefit of the stockholders; and
  - in the pursuit of such primary objective, the directors may exercise managerial discretion to consider the interests of other stakeholders, "provided there are rationally related benefits accruing to the stockholders." *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, 506 A.2d 173, 183 (Del. 1986); and
- in such special circumstances, *Revlon* requires the directors to seek to maximize short- term value and obtain the highest price reasonably available for the benefit of the stockholders, without considering the interests of any other stakeholders.

Both articles note that many states, other than Delaware, have adopted "other constituencies" statutes that expressly provide that directors may consider the interests of other constituencies, such as employees, customers, creditors, suppliers, communities and other societal stakeholders. However, both

articles also note that these statutes are permissive, not mandatory, and hence there is not that much substantive difference between the result under such statutes and Delaware case law, except that the "other constituencies" states generally reject the *Revlon* doctrine. This is so especially by virtue of the fact that, in either case, it is the stockholders, and only the stockholders, who have the power and right to elect and remove directors.

The authors of both articles seem to agree that consideration of stakeholders in addition to stockholders should be part of the corporate managerial process. However, they differ as to how such result would be better accomplished.

Professor Rock, argues, among other things, that this objective should be pursued by external legislation regulating the activities of the corporation – such as regulation governing employment, environmental matters, the distribution of profits, disclosure and reporting – and not by any changes to the corporation law itself. Compliance with applicable law should be to the benefit of other stakeholders and, ultimately, result in a benefit to the stockholders, while non-compliance would presumably be to the detriment of all stakeholders.

Justice Strine, on the other hand, argues, among other things, that corporation law generally should be revised and fashioned on the model of the statutes governing the public benefit corporation ("PBC") as adopted in several states including Delaware (Chapter XV of the Delaware General Corporation Law). While, under Delaware case law and the "other constituencies" statutes of other states, the board <u>may</u> consider the interests of other stakeholders but is not required to do so, the board of a PBC <u>is required</u> to manage the corporation "in a manner that balances the stockholders' pecuniary interests, the best interests of those materially affected by the corporation's conduct, and the public benefit or public benefits identified in the certificate of incorporation."

The two articles should be read in full for thorough and eloquent discussions of the issues involved. The foregoing outline barely scratches the surface.

Neither Professor Rock nor Justice Strine discusses how, under existing law, the directors of a corporation (other than a PBC) should determine which "other constituencies" should be considered or in what manner, or to what extent, the corporation should seek to support their interests, although, as noted above, Professor Rock does confirm, and Justice Strine acknowledges, that current Delaware case law does require that actions taken to further the interests of other stakeholders must be "rationally related to benefits accruing to the stockholders". Nor do they address in any detail a number of other questions that should probably be considered, in the exercise of prudent governance, before a corporation (other than a PBC) pursues any socio/political/economic interest that is not, at least indirectly, for the benefit of the stockholders:

- should the executive officers of a corporation pursue such an interest without the approval of the board of directors?
- should the board of directors authorize or direct the executive officers of a company to pursue an interest without any authorization or request by the stockholders?
- should the board solicit the views of the stockholders prior to the pursuit of such an interest?
- should the board act pursuant to the informal request of a holder of a significant (but non-

controlling) number of shares, or only pursuant to the formal request or direction of stockholders expressed in a resolution adopted by stockholders?

- could an action by a corporation that is not, directly or indirectly, for the benefit of the stockholders be deemed *ultra vires*, at least if not requested or authorized by the stockholders?

These questions, which arise in the context of political contributions, lobbying efforts and general political activism in addition to more direct corporate undertakings, are generally governed by the law of the state of incorporation. The answers may not always be crystal clear.

This note was prepared by J. Anthony Terrell as of June 26, 2021. Mr. Terrell is of counsel to Bracewell LLP, resident in the New York office. However, the views expressed herein are those of Mr. Terrell and do not necessarily reflect the views of the firm or any bar association of which Mr. Terrell is a member.

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