

A Brief Response Regarding Stakeholder Governance

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The recently published “The Friedman Essay and the True Purpose of the Business Corporation” defends a view of stakeholder governance¹ that reflects the following two basic flaws:

1. It misstates to whom the fiduciary duties of directors of Delaware corporations (and of corporations organized in other states that follow Delaware law) are owed and, accordingly, the assured scope of protection of the business judgment rule for directors.
2. It ignores the reality that the interests of nonshareholder stakeholders can be — and increasingly are being — taken into account by corporations governed by Delaware law.

We have addressed each of these points at length in our prior memos.² And we have offered in those memos guidance to directors regarding how to navigate legitimate and permissible efforts to consider nonshareholder stakeholder interests. We will not repeat that.

However, because of its central importance to the fiduciary duty and protection of directors, we address the following statement in the memo:

I continue to advise corporations and their boards that — **consistent with Delaware law** — they may exercise their business judgment to manage for the benefit of the corporation and all of its stakeholders over the long term. That **it is the corporation, qua corporation, that commands the fiduciary duty of its board of directors.** (Emphasis added.)

This does not correctly describe Delaware law. As former Delaware Supreme Court Chief Justice Leo E. Strine, Jr. has stated:³

[A] clear-eyed look at the law of corporations in Delaware reveals that, within the limits of their discretion, **directors must make stockholder welfare their sole end**, and that other interests may be taken into consideration only as a means of promoting stockholder welfare. (Emphasis added.)

If a board’s decision-making process proceeds on the basis of a misconceived view regarding to whom the directors owe their fiduciary duties, we believe that the Delaware courts may not accord the directors the protection of the business judgment rule, but, rather, may apply the more rigorous entire fairness standard of review.

¹ “The Friedman Essay and the True Purpose of the Business Corporation,” posted on the Harvard Law School Forum on Corporate Governance blog on September 17, 2020.

² See our client alerts “Stockholders Versus Stakeholders — Cutting the Gordian Knot” (Aug. 5, 2020); “An Alternative Paradigm to ‘On the Purpose of the Corporation’” (June 2, 2020); “Directors’ Fiduciary Duties: Back to Delaware Law Basics” (Feb. 19, 2020); and “Putting to Rest the Debate Between CSR and Current Corporate Law” (Sept. 7, 2019). Our focus in this and prior client alerts on stating what Delaware director fiduciary duty law is currently for business corporations, rather than on alternative approaches, is necessary for purposes of advising directors today.

³ 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 Law Review* 761,768 (2015). See also Robert G. Eccles, Leo E. Strine, Jr. and Timothy Youmans, “Purpose With Meaning: A Practical Way Forward,” posted on the Harvard Law School Forum on Corporate Governance blog on May 16, 2020. (“In the leading jurisdiction, Delaware, management *may* treat other stakeholders well so long as there are rational relating benefits to stockholders.”) (Emphasis in the original.)