

THIS, I BELIEVE: A NEW LOOK AT CORPORATE PURPOSE, DIRECTOR PRIMACY AND THE BUSINESS JUDGMENT RULE

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I'm sorry I can't be there with all of you.¹ I took this new job about nine weeks ago as the dean of Creighton University school of law and I think this may prove to be a good example of me trying to do too much, but we'll see how we go.

I appreciate the opportunity to be with you, and one of the things that I'm really looking at is trying to look at an evolving concept of corporate purpose. Where I started with the CLE materials I shared are the materials related to what I discussed last year, which was the concept of social enterprise, enabling statutes and the law of director primacy.² The basic thesis was the idea that we have social enterprise entities, which suggest that the corporate or business purpose of any other type of entity is very narrow and very specific. And so my view looks at the corporate purpose and how corporations should operate generally, and the managers, and I argue the people who are in charge of the entity should have broad latitude in how they view things absent some form of self-dealing.

And that's not a particularly unique proposition, I just happened to take it a little bit further than others might. And, so one of the things that's really interesting for me working at Creighton as a Jesuit institution is looking at our spiritual and religious mission. One of the values, Jesuit values, is the concept of assuming positive intent, which is certainly not unique to the Catholic faith or to Jesuits. But is a good filter for thinking about how people operate.

And it occurred to me that that concept of assuming positive intent is actually very consistent with how I think of the business judgment rule

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¹ This article is based on a transcript from a presentation Friday, September 27, 2019. The text has been edited for clarity and organization.

² Joshua P. Fershee, *The End of Responsible Growth and Governance?: The Risks Posed by Social Enterprise Enabling Statutes and the Demise of Director Primacy*, 19 TENN. J. BUS. L. 361 (2017).

and the role directors have in operating and making decisions for business. That is, as we look at what decisions directors make, it's my argument that we should be assuming positive intent, as opposed to looking for nefarious intent. As opposed to looking for thing to challenge And I think that's consistent with a lot of the traditional concepts of the business judgment rule.

And so as we look at corporate purpose, and one of the things that triggered me thinking about this, a couple of years ago³ the modern corporation statement on company law had ten fundamental rules. Steve Bainbridge⁴ and others have looked at this, and the tenth rule of modern corporate statement says this:

Contrary to widespread belief, corporate directors generally are not under a legal obligation to maximize profits for their shareholders. This is reflected in the acceptance in nearly all jurisdictions of some version of the business judgment rule, under which disinterested and informed directors have the discretion to act in what they believe to be in the best long term interests of the company as a separate entity, even if this does not entail seeking to maximize short-term shareholder value. Where directors pursue the latter goal, it is usually a product not of legal obligation, but of the pressures imposed on them by financial markets, activist shareholders, the threat of a hostile takeover and/or stock-based compensation schemes.⁵

All right, so interestingly here, it still suggests that the decision making is really to be in the best long-term interest, as opposed to just the entity's short-term interest. Certainly, several commentators have challenged that Chief Justice Strine has suggested that the profit maximization is the only role, or at least the only filter for how we should be looking at what board members are making decisions. Strine has said that "The relationship

³ Joshua P. Fershee, *This I Believe: On Corporate Purpose and the Business Judgment Rule*, BUS. L. PROF BLOG (Mar. 19, 2015), https://lawprofessors.typepad.com/business_law/2015/03/this-i-believe-on-corporate-purpose-and-the-business-judgment-rule-.htm. This portion of the piece is based on this blog post.

⁴<http://www.professorbainbridge.com/professorbainbridgecom/2015/03/the-corporate-purpose-strine-versus-the-modern-corporation-project.html>.

⁵ *The Modern Corporation Statement on Company Law*, <http://www.purposeofcorporation.org/modern-corporation-statements.pdf>.

between the shareholder wealth maximization norm and the business judgment rule, . . . explains why the business judgment rule is consistent with the director's "legal obligation to maximize profits for their shareholders."⁶

I don't necessarily disagree that strongly with the concept of profit maximization for shareholders, but I do think that directors have broad latitude in determining what that even means, subject to shareholders' vote and their ability to change the directors' decision making by replacing the directors when the time to vote comes. .

Chief Justice Strine says that "the corporate law requires directors, as a matter of their duty of loyalty, to pursue a good faith strategy to maximize profits for the stockholders."⁷ And again, I think there's some truth to that, but again what it means to maximize profits, is I think, in the first instance, really the director's call and not the shareholders' call. Because, of course, all shareholders or many shareholders, have very different views as to what it is they want out of an entity. Some shareholders want the corporation that to pursue investments as a long-term retirement strategy; they want long-term growth. Some are seeking dividends, and some are seeking a short turnaround to make a quick profit so they can sell. Directors are thus inherently balancing all of those goals. If their job is to look at shareholder maximization as a group, they certainly can't be serving every individual shareholder at any given time, because of the different views and needs to each shareholder.

My filter on all of this, has led to different interpretations. I have been criticized as being overly conservative, pro-business in a variety of ways. And I think it was Chief Justice Strine who referred to several of my comments in an article as a liberal commentator, so I'm covering a lot of ground, it appears, with how I view things.⁸

So one of the things that for this start of it, I look back and again, back in 2015, I looked at the old model from the Edward R. Murrow radio show "This I Believe," and I thought out a basic idea of how I'd respond

⁶ 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 (2015); U of Penn, Inst for Law & Econ Research Paper No. 15-08. Available at SSRN: <https://ssrn.com/abstract=2576389>.

⁷ Leo E. Strine, Jr., *Essay: Our Continuing Struggle with the Idea that For-Profit Corporations Seek Profit*, 47 WAKE FOREST L. REV. 135, 155 (2012).

⁸ *Id.* at 149–50 n.44.

to the model rule that was provided just a minute ago. This is what I believe about corporate purpose and the business judgment rule:

I believe in the theory of Director Primacy. I believe in the Business Judgment Rule as an abstention doctrine, and I believe that Corporate Social Responsibility is choice, not a mandate. I believe in long-term planning over short-term profits, but I believe that directors get to choose either one to be the focus of their companies. I believe that directors can choose to pursue profit through corporate philanthropy and good works in the community or through mergers and acquisitions with a plan to slash worker benefits and sell-off a business in pieces. I believe that a corporation can make religious-based decisions—such as closing on Sundays—and that a corporation can make worker-based decisions—such as providing top-quality health care and parental leave—but I believe both such bases for decisions must be rooted in the directors’ judgment such decisions will maximize the value of the business for shareholders for the decision to get the benefit of business judgment rule protection. I believe that directors, and not shareholders or judges, should make decisions about how a company should pursue profit and stability. I believe that public companies should be able to plan like private companies, and I believe the decision to expand or change a business model is the decision of the directors and only the directors. I believe that respect for directors’ business judgment allows for coexistence of companies of multiple views—from CVS Caremark and craigslist to Wal-Mart and Hobby Lobby—without necessarily violating any shareholder wealth maximization norms. Finally, I believe that the exercise of business judgment should not be run through a liberal or conservative filter because liberal and conservative business leaders have both been responsible for massive long-term wealth creation. This, I believe.⁹

⁹ Fershée, *supra* note 3.

I think that that is still a fair statement. I would modify some of those things. And one of the things worth looking at are some of the entities that have had some very public criticisms or overviews of their decision-making. Ones I think I'd like to focus on first, looking at CVS briefly.¹⁰ CVS, if you might recall, a little while ago had decided to have tobacco products in their stores, which was going to lead to a two-billion-dollar reduction in revenue. And so that was unlike some of the other ones we'll talk about, didn't get as much scrutiny as one might expect, in looking at a two-billion-dollar revenue reduction, but the argument that they made in terms of the public relations view was to say, essentially, "Look, we have 26,000 pharmacists and nurse practitioners and we're expanding it to the health care services directly, so it seems contrary to our mission as an institution to keep selling tobacco."

And of course, the profit maximization response might be, "Yes, but two billion dollars is two billion dollars and you already know you have access to that kind of revenue." But by the same token, they made some very clear business decisions saying that they didn't think that number was very large in context. They said it was around 17 cents per share and they believed that growth in the healthcare sector would out-pace that, so justify the business decision.

I think that it's great that the company would look at it that way, and I think it was actually wise the company would explain it that way. But I would suggest that as a board, they should be able to make that decision solely based on what their vision is for the future of the entity. And something like this, where it's easy to look at two billion dollars and say that's an awful lot of money, but it's not everything. Now, if you're a two-billion-dollar company and you decide to stop selling the only thing you're selling, it does change the calculation. But it seemed to me that this should be something that shouldn't have faced as much criticism as it did, even though that was relatively modest criticism as opposed to some other circumstances.

¹⁰ See Joshua P. Fershée, *CVS: More Evidence Courts Are Creeping into the Boardroom*, Feb. 11, 2014, https://lawprofessors.typepad.com/business_law/2014/02/cvs-more-evidence-courts-are-creeping-into-the-boardroom.html.

So looking more recently, Dick's Sporting Goods, following the Parkland shooting in Florida, decided that they were going to limit gun sales to people who were 21 or over.¹¹ As the Wall Street Journal reported:

Ed Stack, the chairman and chief executive of Dick's Sporting Goods Inc., arrived at work the Monday after a gunman killed 17 people at a school in Parkland, Fla., nearly certain the outdoor retailer should limit sales of some guns. . . .

Dick's Financial Chief Lee Belitsky asked, "So what's the financial implication here?" according to Mr. Stack. "I basically said, I don't really care what the financial implication is, but you're right, we should look."

Company executives convened the board via teleconference to explain the proposed plan, took some time to reflect, then gathered again a few days later to vote. "It was unanimous that we should do this and stand up and take a stand," said Mr. Stack, whose family holds a controlling stake in the retailer.¹²

And so after having a board meeting, it was unanimous that the company should stand up and take a stand. The Chief Financial Officer, though, held the controlling stake in the retailer. So, there was ultimately this question about whether the board had a right to restrict gun sales, and whether the board was operating properly in doing so.

Ultimately here, I think if we assume positive intent, I think it's fair to look at this and say Dick's was certainly not trying to undermine their business focus looking at the long-term impacts of continuing down the path that they were going down in determining something was not particularly safe. In looking at that, and of course a lot of this is based on my Business Prof Law Blog posts and things that I've written, which I think is appropriate given the setting.

¹¹ Joshua P. Fershée, *Not Every CEO Opinion is a Breach of Fiduciary Duty (Most Aren't)* (Dec. 11, 2018), https://lawprofessors.typepad.com/business_law/2018/12/not-every-ceo-opinion-is-a-breach-of-fiduciary-duty-most-arent.html.

¹² Sarah Nassauer, *How Dick's Sporting Goods Decided to Change Its Gun Policy*, WALL ST. J. (Dec. 5, 2018), <https://www.wsj.com/articles/how-dicks-sporting-goods-decided-to-change-its-gun-policy-1543955262>.

Dick's was being criticized for not maximizing shareholder value with its decision. But Jack Welch, the CEO of GE from 1981 to 2001, who was certainly well recognized for his success in business and his role in maximizing shareholder value, gives different perspective. .

Jack Welch was known for saying the concept of shareholder value was quote,

the dumbest idea in the world. Shareholder value is a result, not a strategy [Y]our main constituencies are your employees, your customers and your products. Managers and investors should not set share price increases as their overarching goal Short-term profits should be allied with an increase in the long-term value of a company.¹³

Right?

And I think that's consistent with ultimately what I'm trying to argue here. That is the shareholder wealth maximization is a result being sought, not a strategy in it of itself. The board of directors has to make basic decisions on the course they're going to take. Some of those will be controversial, and directors are subject to being voted out by the shareholders, certainly if they take a course of action that is not consistent with what shareholders are looking for. But then ultimately, when it comes to director decisions, absent some sort of fraud or illegality, we should assume positive intent and assume they are looking at the best interest of the entity.

And sometimes that can include a moral, ethical, perhaps religious overlay that is acceptable in this context. Again, as long as you can't show some sort of fraud or self-dealing. One of the most high-profile recent decisions that was criticized in this way was Nike's decision to feature Colin Kaepernick in their advertising. This was a decision that was bringing Colin Kaepernick as the face of its Just Do It campaign, and it faced a lot of scrutiny. The day after the ad campaign, they lost \$3.75 billion in market cap in response, at least apparently, to that ad campaign.¹⁴

¹³ Steve Denning, *Making Sense of Shareholder Value: 'The World's Dumbest Idea'*, FORBES (July 17, 2017), <https://www.forbes.com/sites/stevedenning/2017/07/17/making-sense-of-shareholder-value-the-worlds-dumbest-idea/#333393b02a7e>.

¹⁴ Joshua P. Fershée, *Nike's Kaepernick Ad Is the Most Business Judgmenty Thing Ever* (Sept. 13, 2018), https://lawprofessors.typepad.com/business_law/2018/09/nikes-kaepernick-ad-is-the-most-business-judgmenty-thing-ever.html.

And so the question was made of how much and what kind of information regarding projected backlash that Nike's Board needed to review in order to satisfy its duty of care. After going back and forth on this in a variety of ways, I don't think Nike had to do a whole lot of looking at that. The market cap of at least the short-term implications of that, in my view, shouldn't matter that much. If we assume positive intent, we assume they are making a decision for the best interest of the entity, we go from there.

So in the same way, I think if we assume you know, look at they lost \$3.75 billion the day or two after the ad campaign, a couple weeks later they had gone up, in terms of the value of the entity well beyond where they were before the ad campaign. And I don't think either should be used as evidence of director indiscretion or failure in how they were thinking. That is, I don't think we should use the short-term losses as evidence that they did something improper, nor should a longer-term gain end up being evidence that they acted properly.

The is similar to Dick's, by the way, when Dick's Sporting Goods decided to change the amount of space that weapons had, for example, on their sales floor. That decision had an immediate short-term reduction in overall revenues, not long thereafter, it led to an increase though in profit. Why? Because by taking guns off the floor, they increased it with a higher margin and higher profit volume of other items that lead to more profitability.

But again, the decisions, it doesn't have to work to be a properly made decision. And so if we assume positive intent from what the directors were trying to do, I think we end up in ultimately a better spot.

So, the last example that I will give on this comes from something we're looking at, at my institution. There's a very strong wave of undergraduates trying to get the university to divest from the university investments and endowment to divest at all fossil fuel investments. The accepting and giving of the endowment and the student argument is rooted in the rational thinking and concern for the environment and climate change. They say we should, therefore, absolutely divest in all ways from fossil fuels.

Now, I believe completely in the challenges that we face from climate change, and I believe that we need to be taking more action. I'm just not sure that divestment makes the best sense. And here's how that's relevant to our discussion: First, I would say that because I chose not to travel to see you, am I somehow a better person and that I saved the environment

in some small way by not getting on a plane or getting in a car to come to visit you? Probably not, especially because that decision was not based on climate change or fossil fuel use. It was made for other reasons.

Nonetheless, most of us use fossil fuels every day. Our ability to communicate is at least in some ways linked to electricity, which note is almost always largely fossil fuel based. Most of us drive to work. Even if you drive a hybrid vehicle, if it's not a hybrid plugin, or a pure electric vehicle, fossil fuels are the fuel for transportation. And of course, we can't make batteries and a lot of the things that we need for pure electric vehicles without fossil fuels as some portion of the process, at least currently.

When I was young, a big part of divestment was focused on South Africa and divesting from investment there to protest the practices of apartheid. And there, divestment advocates were saying they did not want to do business with South Africa for any purpose, because they did not believe in anything that involves the government regime. Here, I think there's an argument that could be seen as parallel, that we feel about fossil fuels the same way. But, by participating in an environment and an economy that is largely driven in some portion by fossil fuels, I think there the two situations are different.

I also have to believe that by having a voice at the table, the shareholders can, and some shareholders have demonstrated in large companies, that you have a role demanding that the company have a better process for how they look at the future of environmental harms, what the business model is and what climate change impacts will have both on the environment, but also on the long-term liability of the company, and demanding some action. By divesting and having shareholders that care about those things no longer be a part of the conversation, you see the floor to people who don't care, and so I think that's a grave risk.

However, if going back to where we started, if we believe that the corporate obligation, the directors' obligation is only to maximize profit without regard to anything else, divestment makes complete sense. Right? Because you can believe there is no point in participating, no point in having a voice at the table, because it is impossible for the directors to even listen to you, if what their following has largely been driven by their fiduciary duties. And that's really where I come back to saying that if we assume positive intent of the board, while they have flexibility to disregard positive action regarding climate change, worker benefits, etc., they also have the flexibility to listen, and evolve, and adjust to address those things.

If we get to the point where we can believe in that, I think we can believe in the ability to help evolve companies who have been committed to being part of the process for moving forward and engaging in change. But if we disregard that and don't believe in positive intent (and of a strong business judgment rule), then really the only answer is to divest and be completely separate of how the entities operate. I think that's counterproductive and inconsistent with the model of this public system, and I think that ultimately is the challenge that we're looking at.

The last thing I want to say is, when we look at this, to some degree, I think we have a model for how we look at the traditional revenue duties. Where a company puts itself up for sale and the fiduciary obligations of the corporate really should solely to finding the best price for the entity (the Revlon rule.) I think that's right, and if there comes a time when it becomes clear what it means to be the role for the board of directors.

But otherwise, when we're not talking about ultimately the big change in control or the entity's existence overall that sales and marketing decisions, safety decisions, and other decisions related to how the company operates and the direction it's going to go, really do belong with the directors. Shareholders should have input, but it is the directors who make the decisions and have the ability to show self-dealing or fraud, we really should not just allow, but embrace the idea that directors should be in charge so that they have the latitude to make decisions. They should have the freedom to be bold in how they decide to serve our communities in the broader attempt, broader benefit.

Of course, that comes with the risk that they decide to ignore those things and serve only to maximize profits for shareholders, and perhaps in the short-term to the detriment of workers and their communities. I would argue that that is clearly permissible. I think that if we're going to have that as potential downside, then we have the opportunity to make broader, more bold decisions that benefit communities, workers, and customers, too. So, with that, I think I will end there. And look forward to hearing what other folks have to say. Thanks very much.