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CAREMARK AND ESG, PERFECT TOGETHER:

A PRACTICAL APPROACH TO IMPLEMENTING AN INTEGRATED, EFFICIENT, AND EFFECTIVE *CAREMARK* AND EESG STRATEGY

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By

Leo E. Strine, Jr.,[*] Kirby M. Smith,[**] and Reilly S. Steel[***]

With increased calls from investors, legislators, and academics for corporations to consider employee, environmental, social, and governance factors ("EESG") when making decisions, boards and managers are struggling to situate EESG within their existing reporting and organizational structures. Building on an emerging literature connecting EESG with corporate compliance, this Essay argues that EESG is best understood as an extension of the board's duty to implement and monitor a compliance program under Caremark. If a company decides to do more than the legal minimum, it will simultaneously satisfy legitimate demands for strong EESG programs and promote compliance with the law. Building on that insight, we explain how boards can marry existing corporate compliance programs with budding EESG programs. By integrating compliance and EESG, corporations can meet growing societal demands in an effective and efficient manner that capitalizes on existing structures. Lastly, we address how EESG and corporate compliance responsibilities should be allocated at the board and senior management level. Instead of separating compliance and EESG oversight, this Essay suggests that boards embrace a functional approach, delegating similar compliance and EESG oversight to the same committee and managers. By situating EESG within the board's existing fiduciary duties, this Essay provides academics, legislators, investors, and managers with a novel framework to conceptualize EESG while also offering a path forward for boards struggling to place the current EESG movement within their existing corporate structure.

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Introduction

With concerns about climate change, growing economic insecurity and inequality, and a growing sense that some entities and industry sectors have grown so large, concentrated and powerful that they have the potential to endanger our lives and the resiliency of our critical supply chains[1] has come renewed concern about whether business entities conduct themselves in a manner that is consistent with society's best interests. The profound human and economic harm caused by the COVID-19 pandemic, and its harmful effects on ordinary workers, will only deepen societal focus about whether our corporate governance system is working well for the many or instead subordinating the interests of employees and society to please the stock market. This concern has many manifestations, but a central one is a demand that corporations, and the institutional investors who control the bulk of their stock, respect the best interests of society and all corporate stakeholders, not solely stockholders.[2] The buzz abbreviation for this is "environmental, social, and governance" (ESG), or as one of us has called it, "EESG."[3]

For corporate directors and managers, this demand is a mixed blessing. Fortunately, many corporate fiduciaries believe that companies are most likely to create sustainable profits if they in fact act fairly toward their employees, customers, creditors, the environment, and the

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[1] *See, e.g.*, Jill E. Hobbs, *Food Supply Chains During the COVID-19 Pandemic*, CANADIAN J. AGR. ECON., May 2020, at 3 (observing "[f]ood supply chains dominated by a few large concentrated processors (e.g., meat packing) may be particularly vulnerable" to supply chain disruptions during the COVID-19 pandemic); Sue Reisenger, *Beyond Antitrust, US Justice Department Expands Its Review Into Big Tech Companies*, LAW.COM (Nov. 18, 2019), https://www.law.com/corpcounsel/2019/11/18/beyond-antitrust-us-justice-department-expands-its-review-into-big-tech-companies/?slreturn=20200431215134# (noting DOJ may investigate large technology companies' handling of consumer data).

[2] *See infra* [●].

[3] The extra "E" for employees—a crucial but oftentimes missing component in the ESG discussion. See Leo E. Strine, Jr., *Towards Fair and Sustainable Capitalism: A Comprehensive Proposal to Help American Workers, Restore Fair Gainsharing Between Employees and Shareholders, and Increase American Competitiveness by Reorienting Our Corporate Governance System Towards Sustainable Long-Term Growth and Encouraging Investment in America's Future* (U. Pa. Inst. for Law & Econ. Research Paper No. 1939, 2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3461924.

communities the company's operations affect.[4] More cynically, corporate fiduciaries fear that this is another "of the moment" movement that will simply pile additional checklist items on top of the already-extensive list of duties imposed on them over the past several decades. Boards and management teams are struggling to situate EESG within their existing reporting and committee framework and figure out how to meet the demand for greater accountability to society while not falling short in other areas.

In this Essay, we propose a way of thinking about EESG that might be helpful to directors and senior managers seeking to efficiently and effectively create a corporate culture and policies that promote ethical, fair, and sustainable behavior without simply heaping additional hours and work on already-stretched employees and directors. To develop the framework for this proposal, we explain the relationship of the supposedly novel and enhanced concept of EESG to the pre-existing duty of corporations and their directors to implement and monitor compliance programs to ensure that the company honors its legal obligations. This longstanding duty, associated with the Delaware Court of Chancery's landmark decision in *In re Caremark International Inc. Derivative Litigation*[5] but rooted in the much older requirement that corporations conduct only lawful business by lawful means, overlaps with and should be integrated into companies' decisions to hold themselves to even higher levels of responsibility.

Understanding and acting on the need to merge EESG and corporate compliance will improve the ability of corporations to do this important work with less stress but more impact. If a company decides to do more than the legal minimum toward its employees, its consumers, the environment, and society as a whole, and implements strong EESG policies and standards to hold itself accountable to those objectives, it will simultaneously satisfy legitimate demands for

[4] *See infra* [●].
[5] 698 A.2d 959 (Del. Ch. 1996).

strong EESG programs and promote compliance with law. By aiming to be better than necessary, you should at least do what is required.

Building on this framework, we also give some suggestions about how directors and managers can implement an integrated compliance and EESG policy efficiently and effectively. Most importantly, we focus on the need to ensure that relevant issues are allocated in a sensible way not only at the management level, which ensures that the appropriate expertise and judgment is brought to bear on the risks companies face and pose to their stakeholders, but also that corresponding reporting and accountability structures exist at the board level. Without a sensible allocation of responsibility and the recognition that diverse expertise is needed to effectively address diverse risks, companies hazard missing key warning signals and failing to turn lofty goals for responsible behavior into effective action.

In showing the natural relationship of EESG with the longstanding duty to comply with the law, we build on a nascent literature that has begun to connect EESG and corporate compliance.[6] For example, in recent work, Stavros Gadinis and Amelia Miazad champion greater corporate focus on "sustainability" as more promising than mere compliance and propose modifying directors' fiduciary duties to include ESG considerations.[7] We agree that a greater focus on sustainability and respect for stakeholders is socially useful, but instead of adding a new component to the traditional fiduciary duties of loyalty and care, we situate EESG within the established legal regime and propose a way for boards to address the demands of EESG and compliance in integrated, efficient, and effective way.

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[6] For an incisive review of this literature, see Elizabeth Pollman, *Corporate Social Responsibility, ESG, and Compliance*, *in* CAMBRIDGE HANDBOOK OF COMPLIANCE (D. Daniel Sokol & Benjamin van Rooij eds., forthcoming), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3479723.

[7] Stavros Gadinis & Amelia Miazad, *Corporate Law and Social Risk*, VAND. L. REV. (forthcoming 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3441375. Oher recent work similarly proposes expanding directors' fiduciary duties on the premise they currently do not sufficiently penalize compliance failures. *See* John Armour, Jeffrey Gordon & Geeyoung Min, *Taking Compliance Seriously*, 37 YALE J. ON REG. 1 (2020).

This Essay proceeds in three parts. Starting with a brief overview of the contemporary debates regarding stakeholders and EESG, Part I observes that the first principle of corporate law is that a corporation must conduct lawful business by lawful means. From this first principle, the Essay then situates today's focus on EESG as an extension of the principle that corporations must act in accordance with the legitimate expectations of society for lawful and ethical conduct. In particular, the Essay explains, as a matter of practical business strategy, the reality is that if a company strives to be an above-average corporate citizen, then it will also be much more likely to simultaneously meet its minimum legal and regulatory duties. In this way, EESG and ordinary compliance should be seen as interconnected and be accomplished in an integrated one-step process. Based on this observation, Part II sketches a high-level framework that allows directors and managers to situate EESG initiatives within their existing compliance and regulatory program. Finally, Part III ends with practical advice for how directors and managers can implement EESG initiatives by integrating it into their existing compliance and regulatory programs. By engaging in a thoughtful updating and integration of existing regulatory reporting and compliance and EESG processes, corporate leaders can efficiently generate robust information about their EESG performance, provide corporate stakeholders with good information about the company's legal compliance and EESG efforts, and simultaneously fulfill their duty to monitor the corporate enterprise. Put simply, by more coherently using the considerable corporate resources already devoted to compliance and EESG, corporations can meet the demand for improved corporate citizenship in a cost-effective manner that does not add undue burdens to their employees, top managers, or directors.

I. The Origins of Today's Intense Focus on EESG

In the last two generations, the prevailing view among many business leaders, institutional investors, and law and economics academics was that corporate law should primarily serve the interests of companies' stockholders, an ideology that has come to be known as "shareholder primacy."[8] This shareholder-focused school had gained ascendancy over another traditional school of corporate law thinking—which was widely held in the era from the New Deal until the Reagan Administration began—that saw the firm as a social institution that should not just seek profit for stockholders, but treat society and other corporate stakeholders like workers with respect.[9] In fact, just two decades ago, two eminent scholars called this "the end of history for corporate law."[10] That is, the consensus that corporations should focus on shareholders' best interests was supposedly so widespread and so obviously correct that all other ideologies, including the purportedly discredited "stakeholderism," were now dead letters.[11]

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[8] *E.g.*, Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO L.J. 439, [●] (2000). We are simplifying a complex issue. In short form, shareholder primacy involves the view that corporations should, within the limits allowed by law and ethics, focus on the best interests of their stockholders. This is exemplified by Milton Friedman's famous New York Times op-ed, Milton Friedman, *The Social Responsibility of Business Is to Increase Its Profits*, N.Y. TIMES, at SM-12, Sept. 13, 1970, and was well summarized by Chancellor Allen in his excellent article, William T. Allen, *Our Schizophrenic Conception of the Business Corporation*, 14 CARDOZO L. REV. 261 (1992). The basic idea is that because stockholders supposedly only gain after all the corporation's other stakeholders have their legal claims satisfied, a focus in corporate law on maximizing gains to stockholders will produce the most social wealth. One of us has argued at length elsewhere that there are many problems with this simplistic concept. Leo E. Strine, Jr., *Corporate Power Is Corporate Purpose I: Evidence from My Hometown*, 33 OXFORD REV. ECON. POL'Y 176 (2017); Leo E. Strine Jr., *Corporate Power is Corporate Purpose II: An Encouragement for Future Consideration from Professors Johnson and Millon*, 74 WASH. & LEE L. REV. 1165 (2017). *See also* sources cited *infra* note [●] (critiquing the shareholder primacy ideology).

[9] Chancellor, later Professor, Allen summarized the historical tension between these two schools of thinking in Allen, *supra* note [●]. It is notable that this shift to shareholder primacy coincided with the Reagan- and Bush-era deregulatory shift. Shareholder primacy arguably makes more sense when there are legal and regulatory mandates "with teeth" in place, provided that shareholder primacy is understood to include an overriding obligation to operate within the law, as even Friedman understood it. *See* Friedman, *supra* note [●].

[10] Hansmann & Kraakman, *supra* note [●], at [●].

[11] This scholarly overstatement, of course, ignored or discounted that in many of the leading economies of the OECD, such as Germany and the Netherlands, the corporate law took a more stakeholder-oriented approach, LENORE PALLADINO & KRISTINA KARLSSON, TOWARDS 'ACCOUNTABLE CAPITALISM: REMAKING CORPORATE LAW THROUGH STAKEHOLDER GOVERNANCE 11 (2018), http://rooseveltinstitute.org/wp-content/uploads/2018/10/Towards-%E2%80%98Accountable-Capitalism%E2%80%99-issue-brief.pdf ("In other advanced industrialized economies, balanced models of corporate governance are the norm. In two-thirds of Europe, workers have a role on the corporate board, and in 13 countries, including Germany and France, worker governance

Just as the rise of nationalist movements around the world suggests that it may have been premature to announce that liberal democracy reflects "the end of history" for government,[12] the need for a series of high-profile corporate bailouts, wage stagnation, rising inequality and economic insecurity, and the resulting political and social consequences have put pressure on the shareholder primacy concept. Likely as a response to these societal concerns, many business leaders, institutional investors, and policymakers have again gravitated toward the view that corporations should serve the interests of all their stakeholders, not just those who own the company's stock. For example, in August 2019, the Business Roundtable—an influential organization comprised of the CEOs of the biggest American public companies—changed its existing statement on the purpose of a corporation—which had been updated in 1997, when shareholder primacy was the vogue—to commit to serving all stakeholders, and not just stockholders.[13] Facing their own political pressures as a result of their growing power and their stewardship over working people's savings, a number of institutional investors—three of whom "hold so many shares in America's public companies that they each control one of the five largest stakes in 24 of the 25 largest U.S. corporations"[14]—have publicly stated that the creation

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rights are extensive across much of the private sector."), and that a majority of American states had adopted so-called constituency statutes permitting boards to treat stakeholder interests with respect, Carline Flammer & Aleksandra Kacperczyk, *The Impact of Stakeholder Orientation on Innovation: Evidence from a Natural Experiment*, 62 MGMT. SCI. 1982 (2015) (analyzing the effect of the enactment of constituency statutes in 34 states between 1984 and 2006).

[12] In *The End of History and the Last Man*, political scientist Francis Fukuyama famously argued that Western liberal democracy had become "the final form of human government." FRANCIS FUKUYAMA, THE END OF HISTORY AND THE LAST MAN [●] (1992).

[13] Business Roundtable, *Statement on the Purpose of a Corporation*, https://opportunity.businessroundtable.org/wp-content/uploads/2020/03/BRT-Statement-on-the-Purpose-of-a-Corporation-with-Signatures.pdf. This change brought the Roundtable's view back in line with those it first took on corporate governance in 1978, when it first spoke on the subject, and reversed the move toward stockholder primacy it made in its 1997 statement. *See* Business Roundtable, *The Role and Composition of the Board of Directors of the Large Publicly Owned Corporation* (1978); Business Roundtable, *Statement on Corporate Responsibility* (1981). *See also* Martin Lipton et al., *The New Paradigm: A Roadmap for an Implicit Corporate Governance Partnership Between Corporation and Investors to Achieve Sustainable Long-Term Investment and Growth*, World Econ. F. (Sept. 2, 2016).

[14] John Morley, *Too Big to Be Activist*, 107 S. CAL. L. REV. (forthcoming 2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3225555 (manuscript at 2).

of sustainable corporate profits requires companies to act fairly towards their stakeholders.[15] Meanwhile, some politicians have called for radical overhauls of the legal regime governing directors' fiduciary duties such that boards would be legally required to consider all stakeholders' interests.[16] And a number of academics have joined the fray as well.[17]

The economic and human crisis caused by COVID-19 will only turn the volume up on calls for greater corporate regard for stakeholders like workers, ordinary-course suppliers, and the communities in which companies operate. After a ten-year economic recovery resulting in substantial measure from a government rescue of the financial sector and a substantial cut of the corporate tax rate from 35% to 21%, one might have expected many corporations to have been well positioned to have balance sheets with prudent reserves that enabled them to weather some period of months without revenues without immediately laying off workers and failing to pay their landlords and ordinary suppliers. But a large number of corporations had failed to build up

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[15] *See* Larry Fink, *A Sense of Purpose: Larry Fink's 2018 Letter to CEOs*, BLACKROCK, https://www.BlackRock.com/corporate/investor-relations/2018-larry-fink-ceo-letter ("To prosper over time, every company must not only deliver financial performance, but also show how it makes a positive contribution to society."); John C. Bogle, *Bogle Sounds a Warning on Index Funds*, Wall St. J. (Nov. 29, 2018); Proxy Voting and Engagement Guidelines, North America (United States and Canada), STATE STREET GLOBAL ADVISERS 8 (Mar. 2018), https://web.archive.org/web/20180723160412/https://www.ssga.com/investmenttopics/environmental-social-governance/2018/03/Proxy-Voting-and-Engagement-GuidelinesNA-20180301.pdf. ("Well-developed environmental and social management systems . . . generate efficiencies and enhance productivity, both of which impact shareholder value in the long-term."); Policies and Guidelines Environmental and Social Matters, VANGUARD (2018), https://web.archive.org/web/20190220221801/https://about.vanguard.com/investmentstewardship/policies-and-guidelines/ ("[W]e believe our approach strikes the appropriate balance between corporate responsibility and our fiduciary obligations. For a critique that institutional investors need to incorporate these statements into their proxy-voting practices, see Leo E. Strine, Jr., *Fiduciary Blind Spot: The Failure of Institutional Investors to Prevent the Illegitimate Use of Working Americans' Savings for Corporate Political Spending*, 97 Wash U. L. Rev. (forthcoming 2020).

[16] *See* S. 3348, Accountable Capitalism Act, § 5, 115th Cong. (2018); Corporate Accountability and Democracy, Bernie, https://berniesanders.com/issues/corporate-accountability-and-democracy (last visited Mar. 29, 2020).

[17] *See* COLIN MAYER, PROSPERITY: BETTER BUSINESS MAKES THE GREATER GOOD (2019); LYNN STOUT, THE SHAREHOLDER VALUE MYTH (2012). Relatedly, academics have also paid significant attention to the rise of "passive" institutional investors, who have often supported ESG reforms. *See* Jill Fisch, Assaf Hamdani & Steven Davidoff Solomon, *The New Titans of Wall Street: A Theoretical Framework for Passive Investors*, 168 U. Pa. L. Rev. 17 (2019); Dorothy Lund Shapiro, *The Case Against Passive shareholder Voting*, 43 J. CORP. L. 101 (2018); Lucian A. Bebchuk & Scott Hirst, *Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy*, 199 COLUM. L. REV. 2029 (2019).

those reserves, having used all their excess cash on stock buybacks and dividends, and thus having no cushion against a serious downturn. Even more importantly, the differential effects of the pandemic on workers has heightened existing concerns about economic inequality. Not only did millions of low-wage American workers lose their jobs, but the fact that their jobs had failed to pay a living wage left them with no safety margin to weather the sudden loss of a job. And those workers who were considered so "essential" to the ongoing functioning of society that they were required to continue working and putting themselves at greater risk of exposure during the pandemic turned out to make much less on average than most Americans.[18] The pandemic also underscored the persistence of profound racial inequality in our economy, as Black workers who kept their jobs were more likely to be in risky, low-wage jobs as essential workers, and Black workers overall were more likely to lose employment and were less wealthy and less well positioned to weather the storm. And bringing together the interrelated nature of what EESG involves, these workers bore the human costs of illness and even death, as the requirement to work in a food processing plant, a shipping facility, or a hospital exposed them to greater risk, and the failure of some of these companies to be able to keep their workers safe led them to have to engage in shutdowns, which further endangered not just their workers' continued employment, but the companies' ability to deliver its products and services and to make money.[19] In the wake of the pandemic, it is likely that public officials, regulators, and private plaintiffs will all take

[18] Kylie McQuarrie, *The Average Salary of Essential Workers*, https://www.business.org/finance/accounting/average-salary-of-essential-workers/ (reporting that "the average salary for essential workers is far below the state's average"); *see also* Susan Lund et al., *Lives and Livelihoods: Assessing the Near-Term Impact of COVID-19 on US Workers* (McKinsey, Apr. 2020) (finding that 86% of vulnerable jobs—that is jobs that could be lost, cut, or furloughed because of the COVID-19 pandemic—paid less than $40,000 per year).

[19] *See* Sarah Thomason & Annette Bernhardt, *Front-line Essential Jobs in California: A Profile of Job and Worker Characteristics*, UC Berkeley Labor Center May 14, 2020), http://laborcenter.berkeley.edu/front-line-essential-jobs-in-california-a-profile-of-job-and-worker-characteristics (finding Latinx and Black workers were most likely to be "employed in front-line essential jobs").

steps to hold corporate America accountable for some of the harm suffered by stakeholders like workers during the crisis, and that many of them will call on corporations to deepen their commitment to good compliance and EESG practices.[20]

For all these reasons, regardless of whether stakeholder interests are framed as an end in themselves or are considered merely "instrumental" in the pursuit of shareholder value,[21] the demand for increased attention to stakeholders is clear. At the same time, shareholder primacy is by no means without its defenders, with some scholars, business leaders, institutional investors, and other commentators continuing to advance views associated with shareholder primacy.[22]

But in this debate about whether for-profit corporate boards must put stockholder welfare first, or may (or must) govern in the best interests of all the corporation's key stakeholders, is too often lost a first principle of corporate law. This first principle adds at least one important caveat to the notion that corporate law makes "stockholder wealth maximization" (or even "stockholder welfare maximization")[23] the fundamental end of corporate law.

That first principle is a simple one, but too often ignored, and it is relevant to today's debate and the growing societal concern about whether corporations and other business entities

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[20] Indeed, some of these groups have already begun to demand greater accountability. *See, e.g.*, Paycheck Security Act, [https://www.warner.senate.gov/public/index.cfm/pressreleases?id=384799E4-5040-4671-80E8-A87A26FB6C7E] (proposing to amend the CARES Act so that companies receiving bailout funds are prohibited from buyback stock, must stay neutral during union organizing efforts and cap CEO pay at 50 times the median wage of the company's workforce); H.R. 6989, Pandemic Anti-Monopoly Act 116th Cong. (2020) (proposing a moratorium on mergers until after the FTC determines that workers, consumers and other stakeholders are no longer in severe financial distress); Andrew Cuomo, *Let's Not Repeat the Mistake of Putting Corporations Ahead of Workers in a Crisis*, Washington Post (May 13, 2020), https://www.washingtonpost.com/opinions/2020/05/13/andrew-cuomo-what-washington-must-do-protect-workers/ (advocating for "[c]orporations that [receive federal bailout money] must hire back [workers] at the same levels that they employed before the onset of the public health crisis and subsequent economic fallout").

[21] *See* Lucian Bebchuk & Roberto Tallarita, The Illusory Promise of Stakeholder Governance (Feb. 26, 2020) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3544978.

[22] *See* Bebchuk & Tallarita, *supra* note [●]; Press Release, Council of Institutional Investors Responds to Business Roundtable Statement on Corporate Purpose (Aug. 19, 2019), https://www.cii.org/aug19_brt_response.

[23] *See generally* Oliver Hart & Luigi Zingales, *Companies Should Maximize Shareholder Welfare Not Market Value*, 2 J. L., Fin. & Accounting 247 (2017) (distinguishing between the shareholder welfare and the firm's market value).

are acting in a responsible and sustainable manner. The first principle is that corporations may only conduct lawful business by lawful means.[24]

This may seem mundane, but that does not undermine its importance. Under flexible chartering statutes, corporations are now typically free to enter into any new business line.[25] But, the bottom line is that any new business must be legitimate and above board, in the sense that it is a line of business that society permits. Likewise, there is an important means limitation that still checks corporate behavior, which is that any strategy or tactic employed to help the company succeed must be lawful, too.

Precisely because of this statutory mandate, corporate fiduciaries are imbued with substantial discretion to manage their corporations in an "other-regarding" manner.,[26] Like a human citizen, corporations can consciously choose to avoid ambiguous grey areas of conduct that risk violating the law.[27] Like a human citizen, a corporation can decide that its reputation

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[24] 8 Del. C. § 101(b) ("A corporation may be incorporated or organized under this chapter to conduct or promote any lawful business or purposes."); Model Corporation Act § 3.01(a) ("Every corporation incorporated under this Act has the purpose of engaging in any lawful business unless a more limited purpose is set forth in the articles of incorporation."); In re Massey Energy Co. Derivative & Class Action Litig., 2011 WL 2176479, at *[●] (Del. Ch. May 31, 2011) ("Delaware does not charter law breakers. Delaware law allows corporations to pursue diverse means to make a profit, subject to a critical statutory floor, which is the requirement that Delaware corporations only pursue 'lawful business' by 'lawful acts.'" (quoting Del. Code Ann. tit. 8, § 101(b)); City of Birmingham Ret. & Relief Sys. v. Good, 177 A.3d 47, 65 (Del. 2017) (Strine, C.J., dissenting) (observing that "fiduciaries of a Delaware corporation may not" cause the company "to flout its environmental responsibilities [to] reduce its costs of operations, and by that means, increase its profitability"); Metro Commc'n Corp. BVI v. Advanced Mobilecomm Techs., Inc., 854 A.2d 121, 131 (Del. Ch. 2004) ("Under Delaware law, a fiduciary may not choose to manage an entity in an illegal fashion, even if the fiduciary believes that the illegal activity will result in profits for the entity."); Desimone v. Barrows, 924 A.2d 908, 934-35 (Del. Ch. 2007) ("Delaware corporate law has long been clear . . . that it is utterly inconsistent with one's duty of fidelity to the corporation to consciously cause the corporation to act unlawfully."); In re Walt Disney Co. Derivative Litig., 906 A.2d 27, 67 (Del. 2006) ("A failure to act in good faith may be shown . . . where [a] fiduciary acts with intent to violate applicable positive law.").

[25] *See supra* note [●].

[26] *See* LYNN STOUT, THE SHAREHOLDER VALUE MYTH 30-31 (2012) (arguing that directors lose their discretion under the business judgment rule "only when a public corporation is about to stop being a public corporation"); Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest*, 80 N.Y.U. L. REV. 733, 738, 756-62 (2005) (arguing that managers always have "some legal discretion (implicit or explicit) to sacrifice corporate profits in the public interest" and that there is a "fiduciary duty to comply with the law even when compliance requires sacrificing profits").

[27] For an insightful analysis of how corporate law treats corporate lawbreaking, see Elizabeth Pollman, *Corporate Disobedience*, 68 DUKE L.J. 709 (2019).

for above-board conduct, for acting in a manner that does not skirt the law and that shows respect for society, is valuable, and based on that business judgment, a corporation can also embrace a culture that gives primacy to ethical practices, even when such practices might not generate the most profit.[28]

This first principle also helps illustrate our central point, which is that a corporation's plan to fulfill its legal compliance obligations should not be seen as something separate and distinct from the corporation's plan to operate in a sustainable, ethical manner with fair regard for all the corporation's stakeholders. Rather, when viewed through the correct prism, there should not be two plans for these related objectives, because the objectives are not in fact meaningfully distinct.

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[28] *See, e.g.*, Paramount Commc'ns, Inc. v. Time Inc., 571 A.2d 1140, 1152-54 (Del. 1989) (reasoning that the fiduciaries' "zealousness" in preserving the company's "'culture,' *i.e.*, its perceived editorial integrity in journalism," supported the trial court's finding that the board's decision "was entitled to the protection of the business judgment rule"); eBay Domestic Holdings v. Newmark, 16 A.3d 1, 33 (Del. Ch. 2010) (Chandler, C.) ("When director decisions are reviewed under the business judgment rule, this Court will not question rational judgments about how promoting non-stockholder interests—be it through making a charitable contribution, paying employees higher salaries and benefits, or more general norms like promoting a particular corporate culture—ultimately promote stockholder value."); Shlensky ex rel. Chi. Nat'l League Ball Club (Inc.) v. Wrigley, 237 N.E.2d 776, 778, 780 (Ill. App. Ct. 1968) (holding that the business judgment rule applied to the decision to protect the culture of baseball as a daytime, not nighttime, sport); *see also* Barnali Choudhury, *Serving Two Masters: Incorporating Social Responsibility into the Corporate Paradigm*, 11 U. Pa. J. Bus. L. 632, 669 (2009) ("In fact, profits may not fully represent the long-term value of the corporation. Thus, issues of goodwill, reputation, preservation of culture, or other deeply held firm values may need to factor into the analysis of determining which outcome most closely aligns with the best interests of the corporation") (footnote omitted). Indeed, outside of Delaware, a majority of American states have adopted constituency statutes that explicitly allow directors to consider interests other than stockholders when making corporate decisions. *See* Bebchuk & Tallarita, *supra*, at 17 (listing the stakeholder groups that directors can take into account when making decisions under different states' constituency statutes). That said, in the narrow context of the sale of corporate control to a third party for cash or so long as the fiduciaries do not "openly eschew[]" any connection between their actions and stockholder welfare., Delaware does impose a duty on boards to act as an auctioneer and maximize share price above all else. *See* eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 32-35 (Del. Ch. 2010) (rescinding a poison pill after finding that the company's fiduciaries deployed the pill "to defend a business strategy that openly eschews stockholder wealth maximization" at the expense of a large minority stockholder); Revlon Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 183 (Del. 1986) ("The Revlon board's authorization permitting management to negotiate a merger or buyout with a third party was a recognition that the company was for sale. The duty of the board had thus changed from the preservation of Revlon as a corporate entity to the maximization of the company's value at a sale for the stockholders' benefit.").

The reasons why are easy to grasp if you think concretely about the basic obligations the law imposes for compliance and the basic obligations that proponents of sustainable, stakeholder governance advocate. Let's start with compliance.

The primary source of the obligation to conduct business lawfully stems from the reality that corporations cannot exist without the blessing of society.[29] You cannot call limited liability in the state of nature, or declare a business separate from its founders. That requires law, and the bottom line of the authorization to act as a business entity is that the business obey the law.

In the landmark *Caremark* decision, Chancellor Allen articulated the corresponding fiduciary duty that corporate directors owed to honor this first principle of statutory corporate law.[30] In his decision, Chancellor Allen observed that:

> Corporate boards may [not] satisfy their obligation to be reasonably informed concerning the corporation, without assuring themselves that information and reporting systems exist in the organization that are reasonably designed to provide to senior management and to the board itself timely, accurate information sufficient to allow management and the board, each within its scope, to reach informed judgments concerning both the corporation's compliance with law and its business performance.[31]

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[29] William W. Bratton, *The "Nexus of Contracts" Corporation: A Critical Appraisal*, 74 CORNELL L. REV. 407, 424 (1989) ("The corporate entity represented a state-created juridical structure only—a 'legal fiction' or an 'artificial entity.' The consensus picture conceptually distinguished this juridical form."); Elizabeth Pollman, *Constitutionalizing Corporate Law*, 69 VAND. L. REV. 639, 644 (2016) ("A corporation comes into being with a charter, which reflects a grant of authority from a sovereign."). *See generally* David Ciepley, *Beyond Public and Private: Toward a Political Theory of the Corporation*, 107 AM. POL. SCI. REV. 139, 142-45 (2013) (arguing that "the corporation is governmental in provenance" due to its dependence on government for its personhood and governance rights); KATHARINA PISTOR, THE CODE OF CAPITAL: HOW THE LAW CREATES WEALTH AND INEQUALITY (2019) (explaining the role of the law in "coding" assets, including stock); STEVEN K. VOGEL, MARKETCRAFT: HOW GOVERNMENTS MAKE MARKETS WORK 17-20 (2018) (examining the role of government in constituting the corporation).

[30] In re Caremark Int'l Derivative Litig., 698 A.2d 959 (Del. Ch. 1996).

[31] *Id.* at 970.

Caremark and other developments such as the federal sentencing guidelines[32] stimulated an increased focus on the need for corporations to adopt sound procedures to ensure that they were conducting their business in a lawful manner. Although liability under *Caremark* is hard to prove,[33] scholars have viewed the case as having enormous value in encouraging more intensive diligence in the area of compliance,[34] amplified by the scrutiny of regulators who have imposed substantial penalties on corporations that have run afoul of the law with weak compliance programs.[35] Indeed, despite the fact that *Caremark* cases rarely result in legal liability,[36] leading corporate counsel regularly remind directors of this duty.[37] And recent *Caremark* decisions denying the defendants' motions to dismiss have resulted in renewed attention to directors' oversight obligations.[38]

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[32] *See* USSG § 8B2.1 (outlining the necessary requirements for a corporation to have "an effective compliance and ethics program" including "exercise[ing] due diligence to prevent and detect criminal conduct" and "promot[ing] an organization culture that encourages ethical conduct and a commitment to compliance with the law").

[33] Stone v. Ritter, 911 A.2d 362, 372 (Del. 2006) ("[A] claim that directors are subject to personal liability for employee failures is possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment.") (internal quotation marks omitted); Guttman v. Huang, 823 A.2d 492, 506 (Del. Ch. 2003) ("A *Caremark* claim is a difficult one to prove."); In re Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 967 (Del. Ch. 1996) ("The theory here advanced is possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment.").

[34] Donald C. Langevoort, Commentary, Caremark *and Compliance: A Twenty-Year Lookback*, 90 TEMPLE L. REV. 727, 728 (2018) ("Since [the *Caremark* decision], compliance has grown in size, scope, and stature at nearly all large corporations."); Miriam Hechler Baer, *Governing Corporate Compliance*, 50 BOSTON COLLEGE L. REV. 949, 967 (2009) ("Even though the Delaware Supreme Court did not formally adopt Allen's approach [in *Caremark*] until over a decade later, lawyers and compliance providers responded to *Caremark* by expanding the level of services available to help directors ensure that proper systems were in place to prevent and detect criminal violations.").

[35] For an incisive article discussing the incentives that federal and state law provide to for-profit businesses to engage in compliance and monitoring efforts to reduce the likelihood that they will violate the law, see Jennifer Arlen & Reinier Kraakman, *Controlling Corporate Misconduct: An Analysis of Corporate Liability Regimes*, 72 N.Y.U. L. REV. 687 (1997).

[36] *See* Elizabeth Pollman, *Corporate Oversight and Disobedience*, 72 VAND. L. REV. 2013, 2031 (2019) ("Oversight liability after a trial on the merits is extremely rare. Instead, the case law has developed through settlement opinions and motions to dismiss under Rule 12(b)(6) and the pre-suit demand requirement of Rule 23.1, with few claims surviving such motions." (footnote omitted)).

[37] *See* Robert C. Bird, *Caremark* Compliance for the Next Twenty-Five Years at 14-22 (Mar. 26, 2020) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3566279 (analyzing twenty-four law firm client memos on the Delaware Supreme Court's decision in Marchand v. Barnhill, 212 A.3d 805 (Del. 2019)).

[38] *See* Marchand v. Barnhill, 212 A.3d 805 (Del. 2019) (reversing the denial of a motion to dismiss in the food safety context); In re Clovis Oncology, Inc. Derivative Litig., 2019 WL 4850188, at *10 (Del. Ch. Oct. 1, 2019) (denying motion to dismiss in the pharmaceutical regulatory approval context); Hughes v. Ho, C.A. No. 2019-0112-JTL (Del. Ch. Apr. 27, 2020) (financial reporting and oversight context); Intermarketing Grp. USA, Inc. v. Armstrong, 2020

With a series of major accounting scandals and a major market-shaking financial crisis all occurring within a decade, federal law also substantially enhanced the requirements for corporations to address financial risk and seat independent board members as the exclusive members of committees relevant to compliance.[39] In particular, lawmakers focused on the independence of the audit committee and its advisors,[40] as well as that of the compensation committee.[41]

Arguably in tension with these developments, however, was a corresponding movement to make corporations more directly responsive to the will of the stock market, at a time when the stock market was becoming more characterized by short-term trading. Thus, at the same time that corporations were being admonished for risky practices and told to avoid them, they were also being made more responsive to the immediate pressures of the marginal traders, and of

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WL 756965 (Del. Ch. Jan. 31, 2020) (environmental compliance); In re McKesson Corporation Derivative Litigation, 2018 WL 2197548 (N.D. Cal. May 14, 2018) (controlled substance compliance).

[39] Sarbanes-Oxley Act of 2002, Pub. L. 107-204, 116 Stat. 745 § 301 (requiring the Securities and Exchange Commission to direct the national securities exchanges to "prohibit the listing of any security of an[y] issuer that is not in compliance with the" requirement that each member of a company's audit committee be independent); *see also* NYSE Listed Company Manual Section 303A.07 ("The audit committee must have a minimum of three members. All audit committee members must satisfy the requirements for independence"); Nasdaq Listing Rule 5605(c)(2) (requiring that "[e]ach Company must have, and certify that it has and will continue to have, an audit committee of at least three members, each of whom must: (i) be an Independent Director.").

[40] *See* sources cited in *supra* note 39; Sarbanes-Oxley Act of 2002, Pub. L. 107-204, 116 Stat. 745, §§ 201-209.

[41] *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376, § 952 (2010).

activist hedge funds.[42] Staggered boards became largely extinct at the biggest companies;[43] withheld votes were used to intimidate independent directors;[44] and proxy contests and pressure campaigns grew not only in frequency, but in their rate of success.[45] Not coincidentally, this time period coincided with predominance of institutional investors over human stockholders, a predominance that facilitated collective action to change corporate management and strategy. Although investors had been burnt badly in two market downturns by excessive corporate risk taking for short-term profit and unethical business practices, stockholder initiatives focused on making companies more, rather than less, responsive to immediate market pressures and paid little to no attention to issues like risk management.[46] Governance rules moved strongly in the direction institutional investors preferred and corporate directors regularly faced mini-

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[42] Edward B. Rock, *Adapting to the New Shareholder-Centric Reality*, 161 U. PA. L. REV. 1907, 1922-23 (2013) (noting that the "cumulative effects" of changes brought about by activists, such as eliminating staggered boards, "be seen in how directors' self-understanding of their roles has evolved" to be more stockholder-centric); John C. Coffee, Jr. & Darius Palia, *The Wolf at the Door: The Impact of Hedge Fund Activism on Corporate Governance*, 41 J. CORP. L. 545, 572 (2016) (observing that activists have gained increased power through their association with pension funds and institutional investors); Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 COLUM. L. REV. 863, 897-99 (2013) (documenting activists increased importance to the governance landscape, especially because of the rise of institutional investors); *see also* Mark R. Desjardine & Rodolphe Durand, *Disentangling the Effects of Hedge Fund Activism on Firm Financial and Social Performance*, 41 STRAT. MGMT. J. 1054 (2020) (showing that activist success is shareholder-centric, short-lived, and may harm other constituencies through decreases in operating cash flow, investment, and corporate social performance); Yonca Ertimur, Fabrizio Ferri & Stephen Stubben, *Board of Directors' Responsiveness to Shareholders: Evidence from Shareholder Proposals*, 16 J. CORP. FIN. 53 (2010) (finding that directors who adopt shareholder proposals supported by a majority of shareholders experience a 20% reduction in their likelihood of losing their board seat or other director positions).

[43] *See* KOSMAS PAPADOPOULOS ET AL., U.S. BOARD STUDY: BOARD ACCOUNTABILITY PRACTICES REVIEW 5 (2018) [hereinafter, PAPADOPOULOUS ET AL., BOARD STUDY], https://www.issgovernance.com/file/publications/board-accountability-practices-review-2018.pdf (noting the proportion of S&P 500 companies that elect directors annually grew from 59% in 2009 to 87% in 2017).

[44] *See* Yonca Ertimur, Fabrizio Ferri & David Oesch, *Understanding Uncontested Director Elections* (Working Paper, August 14, 2016), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2447920 (documenting empirically that shareholders withhold votes affect how boards and companies operate); PAPADOPOULOS ET AL., BOARD STUDY, *supra* note [●], at 6-7 (noting the proportion of S&P 500 companies that use majority voting grew from 59% in 2009 to 92% in 2017).

[45] The rate of proxy contest success has grown considerably in the recent past. As a result of their demonstrated capacity to win fights, activists have been increasingly able to win by extracting settlements from corporate boards. Thus, the percentage of board seats awarded to an activist per campaign has grown steadily, and in 2018, activists won an average of 0.81 seats per campaign, up 103% from 2016. *See* Sullivan & Cromwell, *Review and Analysis of 2019 U.S. Shareholder Activism* *15,
https://www.sullcrom.com/siteFiles/Publications/2019ShareholderActivismAnnualReport.pdf.

[46] *See supra* note [●].

referendums in which investors could express their dismay over any current adverse development.[47] And using the many tools they were given to pressure management, activist investors, aided by other institutional investors, pushed companies to deliver immediate returns, at the risk of being ousted from office or otherwise being publicly embarrassed.[48]

This new dynamic led naturally to an intense focus by corporations on pleasing stockholders, even if doing so harms other key stakeholders such as creditors and, most importantly, employees. During this period, the traditional gainsharing from increased corporate

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[47] *See generally* PAPADOPOULOS ET AL., BOARD STUDY, *supra* note [●] (documenting the changes in governance at S&P Composite 1500 companies from 2009 to 2017). *See also* Fang Chen et al., *Not All Threats Are Taken Equally: Evidence from Proxy Fights*, 55 FIN. REV. 145, 147 (2020) (analyzing the effects of proxy fight threats on corporate behavior and concluding "that even a small likelihood to be targeted in a proxy fight can serve as an effective disciplinary mechanism"); KOSMAS PAPADOPOULOS ET AL., THE LONG VIEW: THE ROLE OF SHAREHOLDER PROPOSALS IN SHAPING U.S. CORPORATE GOVERNANCE, 2000-2018 (2019) (documenting the role of shareholder proposals in changing U.S. corporate governance); Stephen J. Choi et al., *Does Majority Voting Improve Board Accountability?*, 83 U. CHI. L. REV. 1119 (2016) (empirically examining the effects of majority voting). Aside from their success in using proxy fights, withhold campaigns, and the stockholder proposal process to influence corporate strategies and to tilt governance rules more toward a referendum approach to governance, institutional investors have also used the say on pay mechanism to put pressure on companies. When a company's performance declines, institutional investors and the proxy advisory firms will often vote against the exact same pay plan they have supported for several years running, in order to express their dissatisfaction, making the say on pay vote more of a say on current performance vote. Jill Fisch, Darius Palia & Steven Davidoff Solomon, *Is Say on Pay All About Pay? The Impact of Firm Performance*, 8 HARV. BUS. L. REV. 101, 103 (2018) ("Through our analysis of say on pay votes cast between 2011 and 2016, we find that both excess compensation and pay-performance sensitivity affect the level of shareholder support for executive compensation packages. Surprisingly, however, we also find that, even after controlling for these variables, a critical additional driver of low shareholder support for executive compensation packages is the issuer's economic performance. Say on pay votes reflect, to a large degree, shareholder dissatisfaction with firm performance and are not based solely on pay."). Sometimes this pressure extends to then withholding votes on the directors on the targeted company's compensation committee. *See 2019 Proxy Season Review: Part 2* (Sullivan & Cromwell, July 25, 2019), https://www.sullcrom.com/files/upload/SC-Publication-2019-Proxy-Season-Review-Part-2-ISS-Negative-Recommendations-Against-Directors.pdf (documenting ISS's high withhold or against recommendation for directors who are unresponsive to negative say-on-pay votes and other stockholder proposals).

[48] See Christopher Whittall, *Activist Investors Are Spending More and Shifting Their Strategies*, WALL ST. J. (Dec. 6, 2018), https://www.wsj.com/articles/activist-investors-are-spending-moreand-shifting-their-strategies-1544101200 ("Some activist victories have come from getting passive shareholders to support their demands, adding additional pressure. Passive funds, which account for 20% of global investment-fund assets versus 8% a decade earlier, can be helpful allies for activists looking to overcome board-level resistance . . . ."); Coffee & Palia, supra note [●], at 572 (finding that activists' influence is growing in part because of their ability to partner with pension funds and mutual funds); Marcel Kahan & Edward Rock, *Embattled CEOs*, 88 TEX L. REV. 987, 995 (2010) (noting "the change by mutual funds and public pension funds to a more confrontational mode of activism"); Lyman Johnson, *A Fresh Look at Director "Independence": Mutual Fund Fee Litigation and Gartenberg at Twenty-Five*, 61 VAND. L. REV. 497, 534 n.228 (2008) ("Mutual fund culture may currently be changing in another respect, as well—the increased willingness of mutual funds to be more 'activist' investors, just as public pension funds and other institutional investors have been doing for some time on various corporate governance issues.").

profitability and productivity between employees (in the form of salary increases) and stockholders (in the form of dividends and other returns) markedly tilted toward stockholders and top corporate management.[49] This tilt has contributed to much greater inequality and growing economic insecurity and dissatisfaction.[50] Likewise, some observers have expressed concern that the avid pursuit of stock market gains has led corporations to be insensitive (or

[49] We are not arguing in this article that this reduction in gainsharing can be causally attributed to the interaction of greater company responsiveness to stockholders and a simultaneous weakening of worker leverage. That is a complex question and one on which distinguished economists have come to different conclusions, although we note that a thorough new study does reach that conclusion. Anna Stansbury & Lawrence Summers, The Declining Worker Power Hypothesis: An Explanation For The Recent Evolution of the American Economy (NBER Working Paper 27913, 2020), http;//www.nber.org/papers/w 27913 (concluding that the combined effect of eroding worker leverage and increasing stockholder power over companies has contributed importantly to the decline in gainsharing with American workers). *See also* Frank Levy & Peter Temin, Inequality and Institutions in 20th Century America (NBER Working Paper 13106, 2007), https://www.nber.org/papers/w13106.pdf (providing an institutional explanation for changes in income distribution). For present purposes, we confine ourselves solely to observing the undisputed change in gainsharing, its effect on workers, and the pressures put on our corporate governance system by concerns about that effect. Historically, workers shared ratably in the increased wealth society generated. From 1948 to 1979, worker productivity grew by 108.1% while workers' wages grew by 93.2%. Despite the increased productivity and education of American workers, the corporate governance system has shifted over the last decades to prioritize stockholders and capital gains over fair gainsharing that shares the fruits of prosperity with all. *See* Economic Policy Institute, *the Productivity-Pay Gap* (July 2019), https://www.epi.org/productivity-pay-gap/. Likewise, during this period, senior executives were compensated much better than the average worker, but not by an astronomical amount. Lawrence Mishel & Julia Wolfe, *CEO Compensation Has Grown 940% Since 1978* (Econ. Pol'y Inst., Aug. 14, 2019), https://www.epi.org/files/pdf/171191.pdf (showing that the average CEO-to-worker pay ratio was 20-to-1 in 1965). Since the 1980s, this equal gainsharing has eroded. From 1979 to 2018, worker productivity rose by 69.6%, but the wealth created by these productivity gains went predominately to executives and stockholders, with worker pay rising by only 11.6% during this period, while CEO compensation grew by 940%. Econ. Pol'y Inst., *supra* note [●]. That is, over the past forty years, increases in societal wealth have primarily benefited the stockholders, not workers. *See* Michael T. Owyang & Hannah G. Shell, *Taking Stock: Income Inequality and the Stock Market*, ECON. SYNOPSES (2016), https://research.stlouisfed.org/publications/economic-synopses/2016/04/29/taking-stock-income-inequality-and-the-stock-market/ (asserting that " as stock prices and capital returns increase, the wealthy might benefit more than other individuals earning income from labor" and showing that "[t]he steady increase in U.S. income inequality from the 1970s through the early 2000s was accompanied by strong gains in the stock market").

[50] *See generally* Thomas Piketty, Capital in the Twenty-First Century (Harvard 2014) (documenting growing inequality throughout the US and other OECD countries); Thomas Piketty & Emmanuel Saez, *Income Inequality in the United States, 1913-1998*, Q. J. Econ. 118 (2003) (same). Growing inequality has resulted, in part, in increased economic instability. Austin Nicholas & Philipp Rehm, *Income Risk in 30 Countries*, 60 Rev. Income & Wealth S98 (2014) (documenting the rise of economic insecurity in America); *see also* Atul Gawande, *Why Americans Are Dying From Despair*, New Yorker (Mar. 23, 2020) (reviewing Anne Case and Angus Deaton's book Deaths of Despair and the Future of Capitalism and noting that deaths of despair—that is, deaths from suicide, overdoses, and other premature causes of deaths in adults—are correlated with "the percentage of a local population that is employed"). And this economic instability, coupled with growing inequality, likely contributes to the fact that in 2017, for instance, "[j]ust 37% of Americans believe[d] that today's children will grow up to be better off financially than their parents." Bruce Stokes, *Public Divided on Prospects for the Next Generation* (Pew Research Ctr., June 5, 2017), https://www.pewresearch.org/global/2017/06/05/2-public-divided-on-prospects-for-the-next-generation/.

worse) to the long-term consequences of their conduct for the planet's health and the health and welfare of their consumers.[51]

One consequence of this growth in inequality and economic insecurity has been an increasing sense that corporations need to do more than the legal minimum and that the so-called stockholder wealth maximization principle is not just legally erroneous, but socially harmful. Not only that, it began to dawn on even mainstream institutional investors that most of the ultimate investors whose money the institutions manage are human beings who invest for long-term objectives like college for their kids and retirement for themselves.[52] One of us has further argued that because these human investors owe their ability to save mostly to their continued access to a good job, are stuck-in investors who have to stay invested long term, and pay taxes

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[51] Unfortunately, it is not difficult for most Americans to recall numerous examples of corporations behaving callously toward their stakeholders, be they consumers, workers, or the communities and environment in which businesses operate. Increasingly, investors and business leaders are also skeptical that corporations who cut ethical and legal corners will be sustainably profitable, because conduct of that kind tends to get found out over the long term. *E.g.*, McKinsey, *Short-Termism and the Threat from Climate Change* (Apr. 2015), https://www.mckinsey.com/business-functions/strategy-and-corporate-finance/our-insights/short-termism-and-the-threat-from-climate-change; Jamie Dimon & Warren E. Buffet, *Short-Termism Is Harming the Economy*, WALL ST. J. (June 6, 2018), https://www.wsj.com/articles/short-termism-is-harming-the-economy-1528336801; Magali A. Delmas, Nicholas Nairn-Birch & Jinghui Lim, *Dynamics of Environmental and Financial Performance: The Case of Greenhouse Gas Emissions*, 28 Org. & Envir. 374 (2015) (observing that companies who adopt environmentally friendly policies suffer a decline in short-term financial performance and postulating that such a decline may contribute to corporation's weariness to adopt such policies).

[52] BLACKROCK, BLACKROCK INVESTMENT STEWARDSHIP: 2018 ANNUAL REPORT 1 (2018), https://www.BlackRock.com/corporate/literature/publication/blk-annualstewardship-report-2018.pdf ("BlackRock's number one focus, as a fiduciary investor, is on generating the long-term sustainable financial returns on which our clients depend to meet their financial goals."); Policies and Guidelines Environmental and Social Matters, VANGUARD (2018), https://web.archive.org/web/20190220221801/https://about.vanguard.com/investmentstewardship/policies-and-guidelines/ (highlighting that Vanguard "actively engages with portfolio companies and their boards to discuss material risks, ranging from business and operational risks to environmental and social risks" but understands that it "is required to manage [its] funds in the best interests of shareholders and obligated to maximize returns . . . to help shareholders meet their financial goals"); Proxy Voting and Engagement Guidelines, North America (United States and Canada), STATE STREET GLOBAL ADVISERS 8 (Mar. 2018), https://web.archive.org/web/20180723160412/https://www.ssga.com/investmenttopics/environmental-social-governance/2018/03/Proxy-Voting-and-Engagement-GuidelinesNA-20180301.pdf (emphasizing that "[w]ell-developed environmental and social management systems . . . generate efficiencies and enhance productivity, both of which impact shareholder value in the long-term"). About Us, FIDELITY INT'L, https://fidelityinternational.com/about-us/ (announcing that Fidelity "think[s] generationally and invests for the long term").

and consume products and services, they are not served by a corporate governance system that encourages gimmicks, pricing bubbles, or externality risk.[53]

The increased salience of so-called ESG, today's word for yesterday's corporate social responsibility, is one manifestation of these developments. A variety of domestic and international sources have put pressure on companies to adopt corporate policies and plans for sustainable governance. In particular, with the increased concern about climate change, a more intensive focus on corporate carbon impact has been at the forefront.[54] But, other areas of social impact have also had salience. With the online nature of commerce, immense attention has been given to data security and the appropriate use of sensitive consumer and employee information. Corporate practices that seem Orwellian to the public have come under intense scrutiny.[55]

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[53] See Leo E. Strine, Jr., *Who Bleeds When the Wolves Bite? A Flesh-and-Blood Perspective on Hedge Fund Activism and Our Strange Corporate Governance System*, 126 YALE L.J. 1870 (2017) (citing the economic data supporting these propositions); Leo E. Strine, Jr., *Toward Fair and Sustainable Capitalism: A Comprehensive Proposal to Help American Workers, Restore Fair Gainsharing between Employees and Shareholders, and Increase American Competitiveness by Reorienting Our Corporate Governance System Toward Sustainable Long-Term Growth and Encouraging Investments in America's Future* (U. Pa. Law & Econ. Research Paper No. 19-39, 2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3461924 (proposing to reform our corporate governance system so that it more aligned with the economic interests of American worker-investors).

[54] For instance, the fact that teen climate activist Greta Thunberg was named TIME's person of the year is evidence that climate and carbon emissions are top of mind. Charlotte Alter, Suyin Haynes & Justin Worland, *Person of the Year 2019* (TIME), https://time.com/person-of-the-year-2019-greta-thunberg/. And cultural awareness is converging with investor awareness. In 2020, Larry Fink, BlackRock's CEO, focused his annual letter to CEOs on environmental concerns. Larry Fink, *A Fundamental Reshaping of Finance* (BlackRock), https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter. And in December 2019, a group of institutional investors representing over $37 trillion in assets wrote a letter to world leaders urging them to take ambitious steps to tackle climate change. CERES, *Record 631 Institutional Investors Managing More Than $37 Trillion in Assets Urge Governments to Step Up Ambition to Tackle Global Climate Crisis*, https://www.ceres.org/news-center/press-releases/record-631-institutional-investors-managing-more-37-trillion-assets-urge. Companies are responding to this pressure. *See* Steven Mufson, *More U.S. Businesses Making Changes in Response to Climate Concerns* (June 11, 2019), https://www.washingtonpost.com/climate-environment/more-us-businesses-making-changes-in-response-climate-concerns/2019/06/10/a30c86ac-8944-11e9-98c1-e945ae5db8fb_story.html.

[55] *See, e.g.*, Jack Nicas, Karen Weise & Mike Isaac, *How Each Big Tech Company May Be Targeted by Regulators*, N.Y. TIMES (Sept. 8, 2019), https://www.nytimes.com/2019/09/08/technology/antitrust-amazon-apple-facebook-google.html; Sara Fischer, *Top Regulators Battle To Crack Down on Big Tech Giants* (Axios, Sept. 17, 2019), https://www.axios.com/big-tech-regulation-multiple-investigations-ftc-doj-ebdfd6ab-1fbb-40ea-ae08-89299d58a11e.html; Elizabeth Warren, *Here's How We Can Break Up Big Tech* (Medium, Mar. 8, 2019), https://medium.com/@teamwarren/heres-how-we-can-break-up-big-tech-9ad9e0da324c; Audrey Wilson, *European Union Unveils Proposed Tech Rules* (For. Pol'y Feb 19, 2020), https://foreignpolicy.com/2020/02/19/european-union-digital-strategy-proposed-tech-rules-regulation-artificial-intelligence-vestager-zuckerberg-facebook-google-apple-competition-brussels/; Matina Stevis-Gridneff, *E.U.'s New Digital Czar: 'Most Powerful Regulatory of Big*

Largely left out of this early stage of the ESG movement was an important corporate constituency: employees.

The omission of employees from ESG discussions has begun to change as dissatisfaction over stagnant employee wages and growing inequality became too hard to totally ignore. Among policymakers, there has a come a growing interest in the co-determination model,[56] and the U.K. government recently adopted a governance code calling for companies to require a board-level focus on the best interests of the workforce.[57] Recognizing these developments, we will use the term "EESG" to incorporate the interests of employees into the ESG framework instead of just "burying them in the S."[58]

Perhaps the most prominent evidence that the EESG movement has had traction is the Business Roundtable's new statement on corporate governance, which highlighted that businesses "share a fundamental commitment to *all* of our stakeholders."[59] One need not be convinced that this statement reflects a genuine commitment to stakeholder governance or

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Tech on the Planet' (N.Y. Times, Sept. 10, 2019), https://www.nytimes.com/2019/09/10/world/europe/margrethe-vestager-european-union-tech-regulation.html.

[56] *See* S. 3348, Accountable Capitalism Act, 115th Cong. (2018) (requiring the SEC, in consultation with the NLRB, to issue a rule that would mandate that at least 40% of a company's board of directors is elected by the company's employees); S. 915, Reward Work Act, 116th Cong. (2019) (requiring at least one third of directors to be elected by employees); Corporate Accountability and Democracy, *Bernie*, https://berniesanders.com/issues/corporate-accountability-and-democracy/ (last visited Apr. 25, 2020) (proposing that 45% of directors be elected by workers).

[57] The UK Corporate Governance Code (July 2018), https://www.frc.org.uk/getattachment/88bd8c45-50ea-4841-95b0-d2f4f48069a2/2018-UK-Corporate-Governance-Code-FINAL.pdf ("For engagement with the workforce, one or a combination of the following methods should be used [1] a director appointed from the workforce; [2] a formal workforce advisory panel; [or 3] a designated non-executive director").

[58] Some commentators and market participants have lumped employees into the "social" prong of ESG. *See, e.g.*, S&P Global, *What is the "S" in ESG*?, https://www.spglobal.com/en/research-insights/articles/what-is-the-s-in-esg (noting that "[s]ocial factors to consider in sustainable investing include a company's strengths and weaknesses in dealing with social trends, *labor*, and politics") (emphasis added); Blackrock, *ESG Integration*, https://www.blackrock.com/institutions/en-us/solutions/sustainable-investing/esg-integration ("Social (S) [i]ncludes labour issues and product liability, risks such as data security, and stakeholder opposition."); Vanguard, *ESG Investing: Where Your Money Can Reflect What Matters to You*, https://investor.vanguard.com/investing/esg/ ("Social [includes] [r]elationships with employees, suppliers, clients & communities.").

[59] Business Roundtable, *Statement on the Purpose of a Corporation*, https://opportunity.businessroundtable.org/wp-content/uploads/2020/03/BRT-Statement-on-the-Purpose-of-a-Corporation-with-Signatures.pdf. For a thoughtful discussion of the skepticism that exists regarding the BRT and institutional investor statements regarding ESG and stakeholders, see Lisa M. Fairfax, Corporate Purpose and Credible Commitment, [●] (2020).

improved corporate practices to recognize that the statement was not lightly made, that it reflects recognition by the most influential business leaders that more was expected of them, and that if they did not answer the call themselves, new legal mandates could be imposed.

In reaction to this EESG movement, corporations have taken action to adopt policies and practices reflecting their commitment to sustainable governance and ethical treatment of stakeholders.[60] For corporate managers and directors, however, this has come with the natural cynicism of the experienced, folk who have been through waves of buzzwords and who remember only too recently being asked to focus on corporate governance ratings that were obsessed with things like eliminating takeover defenses, paying top management in options rather than salary, and making boards subject to stockholder demands.

Managers and directors are struggling with how to implement a commitment to good EESG practices, along with all their pre-existing legal obligations and business requirements. How do we do this new thing? Where does responsibility for it rest on a day-to-day level in the company? Who should we be hearing from on a regular basis to ensure that the company is progressing towards these goals? And what committee of the board should take charge of it?

This is a natural concern, and one that must be addressed if the goal is for corporations to act in a more sustainable and ethical manner. If EESG just becomes another add-on to a list of already difficult-to-accomplish checklist items, the proponents of greater corporate social

[60] *See, e.g.*, Hannah Zhang, *Dick's Sporting Good Will Stop Selling Guns at 440 More Stores*, (Mar. 10, 2020), https://www.cnn.com/2020/03/10/business/dicks-sporting-goods-remove-guns-from-440-stores/index.html (highlighting Dick's efforts to curb gun sales); Hugh Son, *Goldman Won't Take Companies Public Without 'At Least One Diverse Board Candidate," CEO Says* (Jan 23, 2020), https://www.cnbc.com/2020/01/23/goldman-wont-take-companies-public-that-dont-have-at-least-one-diverse-board-candidate-ceo-says.html (Goldman Sachs will no longer take a company public unless at least one of the company's board members is considered diverse); Brad Smith, *Microsoft Will Be Carbon Negative by 2030*, https://blogs.microsoft.com/blog/2020/01/16/microsoft-will-be-carbon-negative-by-2030/ (announcing that Microsoft will decrease its carbon emission to below zero by 2030).

responsibility, *i.e.*, EESG, will fail to achieve their worthy purpose. To the task of avoiding this wasteful and harmful outcome, we next turn.

II. Toward An Integrated, Efficient, and Effective Approach to Corporate Compliance and EESG

Although we understand, given all the buzzwords and seemingly ever-shifting sentiments for corporations to focus on some new concern, the impulse toward eye-rolling and cynicism over the push for EESG, we are optimistic about EESG for two reasons. First, the demand that corporations treat all their stakeholders and society itself with respect is not a whim; it is a fundamentally critical function of every important social institution.[61] Second, and more instrumentally, because EESG is intrinsic to good corporate management, there is good news: There is in fact an efficient and effective method for corporations to embrace quality EESG standards that does not simply pile EESG responsibilities on top of existing duties of managers and the board. The method we refer to involves the simple but important recognition that the company's compliance and EESG plans should not be separate, but identical, and that the work of implementing that singular plan should be allocated sensibly and consistently across company management and across the board's committee structure itself. That is, if you already maintain a thorough and thoughtful compliance policy, you have a strong start towards a solid EESG policy. To grasp why, focus on the most traditional "E" in ESG, the environment. Without minimizing the importance of carbon emissions, let's not lose sight of the fact that there have been and remain other important ways in which corporate conduct affects the environment. There are other sorts of dangerous emissions (e.g., particulate matter), there are other sorts of harmful excess (think plastic), and there will be evolving standards as new innovations result in unanticipated consequences. Since before *Caremark*, environmental concerns have been a core

[61] For a comprehensive historical argument to this effect, see generally MAYER, *supra* note [●].

focus of corporate compliance programs.[62] This growing focus on climate change and other negative effects of intensive economic activity on the environment has manifested itself in litigation under *Caremark*.[63]

This environmental example is not isolated. To the extent that EESG embraces the responsibility to engage in ethical, safe, and non-deceptive conduct toward company customers,[64] then it also overlaps with compliance. Many *Caremark* cases and regulatory actions have focused on corporations that engaged in allegedly deceptive or otherwise wrongful

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[62] *See* Michael P. Vandenbergh, *Private Environmental Governance*, 99 CORNELL L. REV. 129 140-61 (2013) (documenting the emerging private compliance programs and governance organizations that emerged in the 1970s to 1990s in the wake of landmark environmental legislation, such as the Clean Water Act).

[63] *See* City of Birmingham Ret. & Relief Sys. v. Good, 177 A.3d 47, 50 (Del. 2017) (plaintiffs alleging *Caremark* claims based on "nine misdemeanor criminal violations of the Federal Clean Water Act"); Intermarketing Grp. USA, Inc. v. Armstrong, 2020 WL 756965, at *1, 10-15 (Del. Ch. Jan. 31, 2020) (alleging oversight claims based on liabilities resulting from an oil spill); In re Massey Energy Co., 2011 WL 2176479, at *18-21 (Del. Ch. May 31, 2011) (alleging *Caremark* violations stemming from a mine explosion and associated violations of mine safety and environmental laws); Mercier v. Blankenship, 662 F. Supp. 2d 565, 571-72, 575-76 (S.D. W. Va. 2009) (similar).

[64] *See* Bank of America, *ESG: Impact on Companies Doing Business in American and Why They Must Care*, https://www.bofaml.com/content/dam/boamlimages/documents/articles/ID18_0725/esg_impact_on_businesses.pdf (noting that part of the "S" in "ESG" includes "a company's capacity to generate trust and loyalty with its workforce, customers and society. It reflects the company's reputation and the health of its license to operate . . .").

behavior that exposed consumers to financial harm,[65] unsafe products,[66] or theft of personal data.[67]

Similarly, the responsibility to provide employees with safe working conditions,[68] an environment that is tolerant toward diverse beliefs and backgrounds,[69] and fair wages and benefits[70] overlaps with important compliance duties. As with other EESG factors, the employee factor has been a focus of *Caremark* cases and actions by regulators.[71]

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[65] *See* Shaev v. Baker, 2017 WL 1735573, at *1, 9-15 (N.D. Cal. May 4, 2017) (*Caremark* claim based on allegations involving Wells Fargo's account fraud scandal); In re PayPal Holdings, Inc. S'holder Derivative Litig., 2018 WL 466527, at *1, 6 (N.D. Cal. Jan. 18, 2018) (*Caremark* claim based on alleged violations of consumer financial protection and privacy laws); Rojas v. Ellison, 2019 WL 3408812 (Del. Ch. 2019) (alleging company's board failed to oversee "compliance with California laws governing price-comparison advertising"); In re Capital One Derivative S'holder Litig., 952 F. Supp. 2d 770, 777-79, 785-86 (E.D. Va. 2013) (*Caremark* claim based on alleged consumer financial protection violations involving company's marketing of payment protection and credit monitoring products); Brautigam v. Rubin, 55 F. Supp. 3d 499, 505-507 (S.D.N.Y. 2014) (claim based on alleged failure to oversee company's mortgage-servicing operations).

[66] *See, e.g.*, Marchand v. Barnhill, 212 A.3d 805, 807 (Del. 2019) (alleging *Caremark* claim based on food safety violations); Hutton v. McDaneil, 264 F. Supp. 3d 996, 1010 (D. Ariz. 2017) (same); In re Abbott Labs. Derivative S'holders Litig., 325 F.3d 795, 808-09 (7th Cir. 2003) (alleging *Caremark* claim based on alleged failure to oversee compliance with medical device safety regulations); In re General Motors Co. Deriv. Litig., 2015 WL 3958724 (Del. Ch. June 26, 2015) (alleging company's board and management were liable under *Caremark* due to faulty ignition switches leading to personal injury and death to drivers); Salsitz v. Nasser, 208 F.R.D. 589 (E.D. Mich. 2002) (alleging company's board and management recklessly allowed "Bridgestone/Firestone tires [to be installed] on Explorer vehicles, even though the tires made the Explore prone to instability and rollovers"); In re TASER Int'l S'holder Derivative Litig., 2006 WL 687033, at *17 (D. Ariz. Mar. 17, 2006) (*Caremark* claim based on alleged failure to oversee safety of TASER products); La. Mun. Police Emps.' Ret. Sys. v. Pyott, 46 A.3d 313, 316, 351-58 (Del. Ch. 2012) (*Caremark* claim based on alleged misbranding of pharmaceutical product), *rev'd on other grounds*, 74 A.3d 612 (Del. 2013).

[67] *See* Corporate Risk Holdings LLC v. Rowlands, 2018 WL 9517195, at *2-3 (S.D.N.Y. Sept. 28, 2018) (*Caremark* claim based on alleged failure to monitor cybersecurity practices); In re The Home Depot S'holder Derivative Litig., 223 F. Supp. 3d 1317, 1320-21, 1325-26 (N.D. Ga. 2016) (same); Palkon v. Holmes, 2014 WL 5341880, at *1 (D.N.J. Oct. 20, 2014) (same).

[68] *See generally* Occupational Safety and Health Act of 1970, Pub. L. 91-596, 84 Stat. 1590.

[69] *See generally* Civil Rights Act of 1964, Title VII, Pub. L. 88-352, 78 Stat. 241.

[70] *See generally* Fair Labor Standards Act of 1938.

[71] *See* In re Am. Apparel, Inc. 2014 Derivative S'holder Litig., 2015 WL 12724070, at *2-4, 16-17 (C.D. Cal. Apr. 28, 2015) (*Caremark* claim based on founder and CEO's sexual misconduct toward company employees); In re FedEx Corp. S'holder Derivative Litig., 2009 WL 10700362, at *11 (W.D. Tenn. July 20, 2009) (*Caremark* claim based on alleged misclassification of company employees as independent contractors); In re Massey Energy Co., 2011 WL 2176479, at *18-21 (Del. Ch. May 31, 2011) (*Caremark* claim based on mine safety violations); In re Hecla Min. Co. Derivative S'holder Litig., 2014 WL 689036, at *9 (D. Idaho Feb. 20, 2014) (same); Mercier v. Blankenship, 662 F. Supp. 2d 565, 571-72, 575-76 (S.D. W. Va. 2009) (same); South v. Baker, 62 A.3d 1, 6 (Del. Ch. 2012) (same).

Finally, to the extent that good EESG could be thought to involve yet another E, ethics and the overall commitment to conducting business with high integrity and an other-regarding spirit, EESG also overlaps with compliance. Often, behavior that poses an ethical gut check over whether it is the right thing to do runs up against legal rules deterring corruption and fraud. If a corporation is worried about whether a payment or concession to a foreign official is kosher, that is both a legal compliance concern and an EESG concern. If a corporation is engaging in practices that might, for example, encourage physicians to overprescribe a dangerous drug by a combination of financial and social inducements and deceptive minimizations of patient risk, that is both a legal compliance concern and an EESG concern. And as with the previous EESG factors, these sorts of perceived ethical lapses have often prompted *Caremark* suits.[72]

This overlap is understandable and unremarkable when you think about it from this perspective. Perhaps the most important foundational question corporate directors and managers

[72] *See, e.g.*, In re McKesson Corp. Derivative Litig., 2018 WL 2197548, at *1, 7-12 (N.D. Cal. May 14, 2018) (*Caremark* claim based on alleged maximization of "short-term profits over safety with respect to sales and distribution of prescription opioids" and failure to "properly implement a Controlled Substance Monitoring Program"); In re SFBC Int'l, Inc. Secs. & Derivative Litig., 495 F. Supp. 2d 477, 479-80, 484-86 (D.N.J. 2007) (*Caremark* case based on "a broad range of alleged misconduct" by a company engaged in clinical testing of pharmaceutical products, "from improper personnel choices to the failure to rectify unethical clinical testing practices and unsafe conditions at the company's flagship Miami testing facility"); In re Johnson & Johnson Derivative Litig., 865 F. Supp. 2d 545, 562-79 (D.N.J. 2011) (*Caremark* claims based on alleged regulatory violations related to pharmaceutical product recalls, off-label marketing, and kickbacks); Holt v. Golden, 880 F. Supp. 2d 199, 201 (D. Mass. 2012) (*Caremark* claim based on alleged Foreign Corrupt Practices Act violations); In re Wal-Mart Stores, Inc. S'holder Derivative Litig., 2015 WL 13375767, at *2-3, 8 (W.D. Ark. Apr. 3, 2015) (same); Midwestern Teamsters Pension Tr. Fund v. Baker Hughes Inc., 2009 WL 6799492, at *1, 6 (S.D. Tex. May 7, 2009) (same); Strong v. Taylor, 877 F. Supp. 2d 433, 439-40, 448-49 (E.D. La. July 2, 2012) (same); In re Clovis Oncology, Inc. Derivative Litig., 2019 WL 4850188, at *10 (Del. Ch. Oct. 1, 2019) (*Caremark* claim based on alleged failure to oversee misconduct in seeking approval of new pharmaceutical product from the Food and Drug Administration); Clingman & Hanger Mgmt. Assocs., LLC v. Knobel, 2018 WL 2006763, at *8-12 (S.D. Fla. Jan. 9, 2018) (*Caremark* claim based on alleged failure to oversee for-profit school's compliance with Department of Education regulations); Cook v. McCullough, 2012 WL 3488442, at *6, 8 (N.D. Ill. Aug. 13, 2012) (similar); *Stone v. Ritter*, 911 A.2d 362, 364-65 (Del. 2006) (*Caremark* claim based on Bank Secrecy Act and anti-money-laundering violations).

need to be able to answer to be an effective fiduciary is this one: How does the company make money?[73]

The reason why this simple question is powerful is that it forces you to examine closely what the company does that results in the ultimate profitable sale of a product or service. For a manufacturing company, this means understanding the product you are making and how you make it. This necessarily requires you to think about who will use the product and for what purposes, and the corresponding benefits and risks of doing so. This necessarily requires you to think about your production processes and who they affect and in what manner. This includes the workers involved in production and their safety. This also includes the environmental impact of the plant.

The same is also true when asking how the product gets sold. What are the marketing practices that we use? Do we gather information from our consumers that we do not need to make the sale? Are we reselling that information to others? Are we telling our consumers that we do so? Are we protecting their data?

Permeating the question of how you make money, of course, will be the issue of what human beings are involved in the production and sales process. Do they have safe working conditions? Do you pay them fairly and give them quality benefits? Are you keeping workers at a full-time part-time hour level to avoid giving them benefits? Are you using contracted labor? Do you require your contractors to extend to their employees the same standards you require for treatment of the company's own employees? And to what extent do we attribute the success of the company to its workforce as a whole as opposed to just top management? And are we matching that thinking to the company's compensation system?

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[73] *See* Leo E. Strine, Jr., *Warning—Potential Danger Ahead!* (Directors & Boards, Sept. 2004) ("[T]he first question you must be able to answer before you can serve responsibly as a director: How does the company make money?").

What will naturally flow from asking this core question, and the ones that flow out of it, is an understanding that the legal regimes likely to be most salient for the company are identical to the EESG issues that have the most salience. Why? Because society learns from experience, and the law is likely to have the most relevance to your company in those areas where the company has the most impact on the lives of its stakeholders, be they the company's workers, its consumers, or the communities in which its operations have a material impact. So too will those focused on corporate EESG practices be likely to focus on what is most salient for particular companies in particular industries.

Therefore, by analyzing in a rigorous way how a company makes money, and the impact that has on others, you best shape an effective compliance system. Happily, it is also how best to shape an effective EESG plan. Think about it in this way: If you are seeking to go beyond the legal minimum and to treat all your stakeholders and communities of impact in an ethical and considerate manner, you are by definition minimizing the risk that you will not honor the law. By trying to engage in best practices, you will have a margin of error that keeps you largely out of the legal grey and create a reputation that will stand you in good stead with your stakeholders and regulators when there is a situational lapse.

Even more happily, in addressing EESG's emerging salience, companies should not ignore their past efforts to improve their compliance regimes. Rather, they should build on their prior learning and use the need to report on EESG metrics as an opportunity to become more efficient and effective as a company.

For too many companies, their existing board compliance structures are not well thought out, and may result in an imbalanced approach to legal compliance and risk management that hazards failing to identify and address key areas where the company could negatively affect stakeholders and society—and run afoul of the law.

III. A Practical Way to Think About Organizing and Implementing An Integrative Compliance/EESG Strategy

For a public company seeking to do better and to re-organize their compliance and EESG functions in an integrated, efficient. and effective manner, the most rational starting point involves building on the thought process we have discussed. The company's board, management, and advisors should identify how the company makes money, and the stakeholders it affects in doing so. Now, you might say, does this mean that the board and management should dilate on every source of cash flow. No, you must use your business judgment, which to us implies that you must consider the company's material sources of business and their impact. But, correspondingly, it means making clear as a matter of company policy that the less material a source of cash flow a business line is, the more intolerant the company is of conduct that is legally, ethically, or socially problematic. That is, it must be clear that the company does not even tolerate entering a grey zone in business lines not core to its financial health, and that the company's overall ethics and compliance policies operate even more stringently when the benefit-to-cost ratio for endangering the corporation's reputation as a good citizen is especially poor.

As to material business lines, top management and the board must carefully address the relevant regulatory regimes that constrain the company's conduct, consider the reasons why that is so, and identify the stakeholders whose interests the law seeks to protect. Relatedly, managers and boards should undertake the same inquiry in addressing reputable EESG criteria and their application. Which of these factors is relevant to the business line and what stakeholders are they designed to protect? In this process, managers and boards should attempt to identify the best standards for both compliance and EESG that measure performance in successfully addressing these factors.

The results of these related inquiries should then be integrated. By way of example, consider the environmental "E." The company should consider the regulatory regimes that constrain the company's operation of a business line, why those regimes are in place, and the corresponding EESG standards that apply. The concerns addressed by law and EESG standards will tend to track. Does the law already require the company to compile information in relevant areas that might be useful in tracking not just bare compliance with law, but also with higher objectives of environmentally responsible behavior? Are there accepted and reputable standards by which the company can monitor its fidelity to environmental law, and even better, go further and set a higher standard of responsibility? How might adoption of a voluntary EESG standard and the gathering of information necessary to evaluate whether the company was meeting it simultaneously act as a safeguard for legal compliance? The same will almost certainly be the case for standards involving the fair treatment of employees, safe working conditions, and other elements of being a lawful and ethical employer.

This is an important—and so far overlooked—point in the ongoing discussion about EESG reporting. A substantial amount of the relevant data required for robust EESG reporting is already required to be collected by government regulation or as part of the company's legal compliance monitoring program. In fact, some of the EESG-relevant information is likely already compiled and reported. To wit, most federal and state regulatory bodies require some modicum of ongoing reporting for those entities most likely to cause harm. Drug manufacturers must provide ongoing reports about the efficacy of their products. Likewise, OSHA requires documenting and reporting on workplace hazards and safety. The list goes on, but the point is that regulatory systems already require disclosure that is essential to a quality EESG monitoring and reporting system. And in the instances in which governments do not formally mandate reporting but still set metes and bounds for appropriate conduct, trade and industry groups often coalesce around a best practice in terms of monitoring and reporting. Again, much of the basic task of quality EESG reporting is likely already being done by businesses if they are following the basic precept of conducting lawful business by lawful means.[74]

That said, there is a current challenge that cannot be ignored: the proliferation of different approaches to EESG reporting.[75] This proliferation is inefficient, encourages greenwashing and gamesmanship of the kind that has characterized corporate governance ratings, and threatens to engage companies more in the rhetoric of EESG than the reality of managing a corporation with the goal of being other-regarding toward company stakeholders and

[74] Several of the leading EESG standards already overlap with key compliance areas. For example, SASB's Biotechnology & Pharmaceuticals Standard requires reporting around the company's FDA compliance statistics, something already required by the FDA. Likewise, SASB's Oil & Gas–Exploration & Production Standard and the World Economic Forum's proposed EESG reporting framework requires companies to report on workplace safety, an existing requirement under OSHA.

[75] *See* Jill Fisch, *The Uncertain Stewardship Potential of Index Funds*, ("At the present, however, the metrics for evaluating the social responsibility of a portfolio company or a socially responsible investment fund are problematic – as many commentators have observed, sustainability disclosures are limited, incomplete and largely unreliable."). Indeed, there are tens if not hundreds of ESG-related reporting frameworks currently in circulation. *See, e.g.*, Global Reporting Initiative (GRI) https://www.globalreporting.org/standards/; Sustainability Accounting Standards Board (SASB), https://www.sasb.org/standards-overview/download-current-standards/; World Economic Forum, *Toward Common Metrics and Consistent Reporting of Sustainable Value Creation* (Jan. 2020), http://www3.weforum.org/docs/WEF_IBC_ESG_Metrics_Discussion_Paper.pdf; *Final Report: Recommendation of the Task Force on Climate-Related Financial Disclosures* (June 2017), https://www.fsb-tcfd.org/wp-content/uploads/2017/06/FINAL-2017-TCFD-Report-11052018.pdf. Even though more companies are disclosing EESG-related data, absent standardization, investors will have difficulty comparing the myriad disclosures that companies issue based on the current slew of existing frameworks. *See* Testimony of John Streuer to Senate Banking and Finance Committee (April 2, 2019) ("85% of companies in the S&P 500 already actively report on ESG risk factors voluntarily, through corporate sustainability reports or other corporate disclosures. However, much of the information provided through voluntary disclosures is difficult to compare and inconsistent across issuers, resulting in considerable costs and resource expenditure for investors."); *see also* McKinsey & Company, More than values: The value-based sustainability reporting that investors want (August 2019) (observing that 85% of investors either agree or strongly agree that more standardization of ESG information is required).

society.[76] Until this proliferation is alleviated by private action or legislation,[77] though, the only rational way to proceed is for the company's management and board to exercise judgment and to carefully select the standards it believes are the most relevant, informative, and credible. And here, the compliance reporting systems already in place should provide a useful starting point to decide what additional standards the company should embrace and which of the contending frameworks are the most informative and relevant given the company's impact on society and its stakeholders. Based on its current understanding of its business and reporting, management and the board should be prepared to explain to its stakeholders, including institutional investors and EESG organizations, why it selected the standards it did, and how they will help the company

[76] For instance, most current disclosure around human capital (the extra E in EESG or part of the S in the traditional conception) is done through vague, non-quantitative or boilerplate disclosures. *See* Sustainability Accounting Standards Board, *The State of Disclosure 2017* *21, https://www.sasb.org/wp-content/uploads/2019/08/StateofDisclosure-Report-web112717.pdf?__hstc=105637852.135a89045bd6ea85f68591478e99eb09.1553809423920.1570492048390.1570494269935.17&__hssc=105637852.1.1570494269935. But that may change in the near future. For example, a group of distinguished accounting, business, and academic leaders have developed promising recommendations for improving disclosure in the area of human capital. *See, e.g.*, Coalition for Inclusive Capitalism, *Embankment Project for Inclusive Capitalism* (2018). And under the leadership of Chairman Clayton, the SEC has pressed for more informative disclosure about the worth of and investments in human capital and in areas relevant to how corporations treat their employees. *See* Securities and Exchange Commission, SEC Proposes to Modernize Disclosures of Business; Legal Proceedings, and Risk Factors Under Regulation S-K, https://www.sec.gov/news/press-release/2019-148 (noting that as part of the SEC's modernization effort, publicly traded companies would be required to include "as a disclosure topic, human capital resources, including any human capital measures or objectives that management focuses on in managing the business, to the extent such disclosures would be material to an understanding of the registrant's business, such as, depending on the nature of the registrant's business and workforce, measures or objectives that address the attraction, development, and retention of personnel"). And Professors Jill Fisch and Cynthia Williams have petitioned the SEC on rulemaking related to more comprehensive ESG disclosure, although the SEC has yet to act on their petition. Letter to Brent Fields, Secretary, Securities and Exchange Commission, Oct. 1, 2018, https://www.sec.gov/rules/petitions/2018/petn4-730.pdf. For the SEC to be able to accommodate that demand sensibly, it may well require legislative authorization to take a broader perspective on EESG disclosure, recognizing that its value is not just to investors, and to allow it to seek help from other agencies, such as the Department of Labor and Environmental Protection Agency, that have expertise relevant to setting good EESG reporting standards.

[77] Already, there are private efforts at convergence, particularly in the environmental space. For example, the Task Force for Climate-Related Financial Disclosures is looking to have market players converge around its standard in the area of climate change reporting metrics. *See Final Report: Recommendations of the Task Force on Climate-related Financial Disclosures* (June 2017), https://www.fsb-tcfd.org/wp-content/uploads/2017/06/FINAL-2017-TCFD-Report-11052018.pdf. Ultimately, it may require a combination of government and private sector action to provide the coherence needed. Agreement to implement B minus level reporting metrics by all companies for some period, with a goal of improving them to A level might be more valuable than having companies each implementing different approaches, thus minimizing the ability for any real comparison of behavior and maximizing the chances for greenwashing.

best comply with the law and be a good corporate citizen. Of course, in doing so, it is relevant to consider whether there is increasing convergence around certain standards, because comparability is an important value for all stakeholders and for government regulators.[78] If society is serious about EESG, then corporations must be expected to adhere to some level of consistency in reporting and be held accountable fairly across common dimensions of concern.

This line of inquiry should lead to a more disciplined and integrated approach to compliance and EESG, and should help reveal the key legally required and company-adopted principles and standards that the company will use to encourage ethical behavior and to track whether the company and its employees have met or missed the mark.

When that is done, the next step is critical and has not been done well by many companies even when viewed through the narrower lens of compliance alone. That is the step of determining what expertise is needed to implement the company's compliance and EESG plan, how responsibility for that should be allocated among the company's management team, and, correspondingly, how the board should be organized to oversee management's implementation of the adopted plan.

Diversity is rightly a salient topic in the conversation about corporate citizenship. But diversity is also a hugely relevant consideration when it comes to comprising a board of directors and management team that is adroit at managing a sustainably profitable business that acts as a solid corporate citizen. To this point, we are not referring to the idea that having a board and management team with diverse socioeconomic, racial, ethnic, national, and gender backgrounds might enhance the company's ability to look at key issues from multiple perspectives, have

[78] *See supra* note 46; *see also* Mark Carney, *Breaking the Tragedy of the Horizon – Climate Change and Financial Stability*, https://www.bis.org/review/r151009a.pdf (observing that internationally consistent regulatory standards are important to producing successful EESG disclosure)

greater understanding and empathy toward its stakeholders, and stimulate a more interesting intellectual climate useful for innovation and decision making. That very well may be the case.[79]

But for present purposes, we are referring to the more mundane idea that the world is complex and that diverse expertise is essential to the ability of most corporations to succeed. At the management level and staff level, this is often well understood, and corporations seek out the diverse talent necessary to accomplish their diverse business functions. In corporations whose products involve complex science and safety considerations (say pharmaceuticals), it is vital to have employees with the skill set and experience to enable the company not only to develop and market new products, but to do so in a manner that is safe to consumers and compliant with the intensive regulatory regimes that exist to protect them. It would be unlikely to see a corporation of that kind without employees with relevant educational and industry expertise pervading that area of the business's activity. At the same time, a pharmaceutical company is also likely to have a well-credentialed staff of experts, qualified in areas like accounting and corporate finance, to address those functions. No doubt these different types of experts would gain some understanding of each others' bailiwick through the experience of working in a company in the same industry, but no one would think that they could change jobs without great risk to the company and society.

[79] *See, e.g.*, David Carter, Betty J. Simkins & W. Gary Simpson, *Corporate Governance, Board Diversity and Firm Performance* (Working Paper, Mar. 26, 2002), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=304499 (finding a positive correlation between diverse boards and firm value); Lin Liao, Le Luo & Qingliang Tang, *Gender Diversity, Board Independence, Environmental Committee and Greenhouse Gas Disclosure* 47 British Acct'ing Rev. 409 (2015) (finding that increased gender diversity on a company's board of directors is associated with a higher propensity for the company to make greenhouse gas disclosures); Stephanie J. Creary, *When and Why Diversity Improves Your Board's Performance* Har. Bus. Rev. (Mar. 27, 2019),https://hbr.org/2019/03/when-and-why-diversity-improves-your-boards-performance (discussing strategies for boards to use diversity to improve their company's performance). *But see* Corinne Post & Kris Byron, *Women on Boards and Firm Financial Performance: A Meta-Analysis*, 58 Acad. Mgmt. J. 1546 (2014) (finding mixed evidence for the claim that women on boards increases a company's financial performance).

The problem, however, is that the same kind of sensible deployment of expertise has not characterized how American corporations have addressed risk management, compliance, and ESG. It remains the case that, for a large percentage of American public companies, the audit committee is the corporate committee singularly charged with approving and monitoring the corporation's compliance and risk management system.[80] This is problematic for two interactive reasons: (1) the responsibilities of audit committees in their core domain of accounting and financial compliance, prudence, and integrity have grown even more challenging, complex and time consuming; and (2) corporations rarely face risk and compliance issues only in the financial area, and often have issues of that kind in areas where specialized expertise of a non-financial nature is essential to effective management.

The interactive effect is easy to explain. With increased complexity in accounting and finance has come requirements that audit committees be comprised solely of directors who consider themselves financially expert.[81] Directors whose background is not in finance, but who have other relevant talents, may rightly feel inhibited in declaring themselves to have the depth

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[80] *See* NACB Public Company Governance Survey 2019-2020, *18, https://corpgov.law.harvard.edu/wp-content/uploads/2020/01/2019-2020-Public-Company-Survey.pdf (reporting that 31% of boards locate enterprise risk management in the audit committee, while only 16% of boards locate risk management in a risk committee, although 51% of boards report that the full board is responsible for risk management); *id.* at *25 (noting that 63% of boards locate compliance responsibilities in the audit committee).

[81] Sarbanes-Oxley Act of 2002 § 407 (requiring the SEC to issues a rule that would require publicly listed companies "to disclose whether or not, and if not, the reasons therefor, the audit committee of the [company] is comprised of at least 1 member who is a financial expert"). Likewise, the NYSE and NASDAQ listing rules place similar requirements on publicly traded companies. *See* NYSE Listing Manual § 303A.07(a) cmt ("each member of the audit committee must be financially literate, as such qualification is interpreted by the listed company's board in its business judgment, or must become financially literate within a reasonable period of time after his or her appointment to the audit committee. In addition, at least one member of the audit committee must have accounting or related financial management expertise, as the listed company's board interprets such qualification in its business judgment."); Nasdaq Listing Rule 5605(c)(2) ("Each Company must have, and certify that it has and will continue to have, an audit committee of at least three members, each of whom must . . . be able to read and understand fundamental financial statements, including a Company's balance sheet, income statement, and cash flow statement. Additionally, each Company must certify that it has, and will continue to have, at least one member of the audit committee who has past employment experience in finance or accounting, requisite professional certification in accounting, or any other comparable experience or background which results in the individual's financial sophistication, including being or having been a chief executive officer, chief financial officer or other senior officer with financial oversight responsibilities.")

of finance acumen to qualify. Relatedly, the reality that financial gimmickry and imprudence caused serious economic consequences for the American economy led to increased responsibilities for audit committees in both Sarbanes-Oxley and Dodd-Frank, and complementary Exchange Rules reforms.[82] These enhanced requirements added time to what was already the most burdened board committee.[83]

The resulting time pressures have another important effect. The core duties of an audit committee will mean that the CFO, the head of internal audit, and other top finance officers will not just want, but need, a lot of time with the audit committee. To the extent therefore that the audit committee's scope of responsibility over risk management and compliance is company-wide, there is an obvious danger that the audit committee will not have enough time itself to responsibly consider and address non-financial risks. That is, even if one assumed that it is possible to comprise an audit committee that is not only financially expert but also capable of adroitly addressing all the diverse risk issues a company faces, the chance that it would have the time to do so effectively seems slight.

And the reality is that it is exceedingly unlikely that the skill set you would wish to address the company's other non-financial risks and compliance issues is identical to that you seek in audit committee members. Much more likely, you would want directors with substantial industry and educational expertise in other relevant subjects—such as environmental, food safety, data security, drug efficacy, plant and production safety measures, privacy protections, etc.—expertise that they likely built up by concentrating in those areas during their careers, and

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[82] See *supra* note 52.
[83] *See* KPMG, *Global Board Insights: Audit Committee Workload*, *4, https://home.kpmg/content/dam/kpmg/pdf/2015/10/audit-committee-workload.pdf (surveying 1,500 audit committee members and finding that "the amount of time required to carry out their audit committee responsibilities has increased moderately (51%) or significantly (24%) over the past two years. And 40% said it's becoming increasingly difficult to oversee all the major risks on its agenda given the committee's agenda time and expertise").

not in accounting or finance. Correspondingly, the fact that someone was a top KPMG accountant or a CFO at Fortune 100 company may make her an ideal audit committee member. But that experience may give her no training or expertise to address food safety risk, or cybersecurity.

As important, the time crunch imposed by core financial and accounting duties means that the access that non-financial officers will get to the audit committee will be carefully rationed and less than ideal. It is natural to expect that the CFO and auditors will have an agenda of items to accomplish at each audit committee meeting. Other officers will have to fight for time. This includes the General Counsel, who may often be the most likely to try to make sure that every other officer gets some time with the Committee, often at the sacrifice of important topics the GC herself might ideally wish to discuss.

From a business perspective, the resulting allocation of talent and time is suboptimal and inefficient. By consolidating a critical function too tightly in a committee that cannot perform it effectively, you risk missing issues, you limit communication between the directors and a more diverse set of company officers, and you also are likely to be spreading the work of the board across its members in a highly inequitable way.

The allocation also is counter-intuitive in another obvious sense. It is unlikely that the corporation organizes its management-level approach to risk and compliance in that manner. Much more likely, the corporation has developed methods to balance the competing values in specialization and generalization, and has developed some industry-specific structures to address non-financial risk. To the extent that at the board level those structures are not replicated in some sensible way, the risk is that the board will not be optimally involved in areas of non-financial risk management that are fundamental to the company.

For these reasons, it seems much more effective and efficient to make sure that committee-level responsibility for risk management and compliance is thoughtfully allocated among the board's committees, rather than solely vested in the audit committee. With such a thoughtful allocation should come an alignment of officer-to-board-level reporting relationships, which has the added value of ensuring that the directors get to know and regularly communicate with a broader range of corporate executives. In an era where it is likely that the only insiders on the board will be the CEO and perhaps one other director,[84] this is no small benefit in itself, as it opens many more windows into the company for the board and creates a much better insight into corporate culture.

More specifically, though, it facilitates management-to-director communication on a regular basis on all the material, industry-relevant areas of risk and compliance. And it does so in a way that allows the managers and directors best equipped to identify and deal with risks in the first instances the best chance to do so. Such a structure also maximizes the ability of a company to comprise a board with directors having the full range of talents the company's business needs, because directors can be seated and given roles that make sense for them, and they are not required to pretend to a specialized expertise they do not truly have.

This topic is an urgent one now as corporations grapple with where to situate EESG. To date, there has been a noticeable trend toward entrusting the nominating and corporate governance committee with responsibility for approving and overseeing the implementation of the company's EESG policies and standards monitoring.[85] Rather than integrate EESG into the

[84] *See* SpencerStuart, U.S. Spencer Stuart Board Index 15 (2019), https://www.spencerstuart.com/-/media/2019/ssbi-2019/us_board_index_2019.pdf ("85% of all S&P 500 board directors are independent . . . . Boards average 9.1 independent directors and 1.6 affiliated directors.").

[85] NACB Public Company Governance Survey 2019-2020, at 27, https://corpgov.law.harvard.edu/wp-content/uploads/2020/01/2019-2020-Public-Company-Survey.pdf (reporting that 30% of boards locate ESG responsibilities in the nominating and governance committee, compared to just 5% that locate those responsibilities in the audit committee, although 55% of boards still locate ESG responsibilities at the full board level).

corporation's compliance oversight process, most companies seem to be keeping primary responsibility for compliance in the audit committee, while putting EESG in another committee or contending the whole board is on point on those issues, and therefore bifurcating, trifurcating, or otherwise splitting up what ought to be one integrated approach to inextricably linked goals. For the reasons we have discussed, this is wasteful, risks missing key issues of concern, and will likely be less effective in creating an ethical and socially responsible corporate culture.

To more effectively and efficiently organize the compliance and EESG function of the corporation, the board should integrate them and allocate responsibility to committees in a functionally sensible way. This allocation of responsibilities would track the skills needed to do the task well and mirror the way the task is allocated at the management level. A sensible committee structure will not put all the weight on the audit committee for the most intensive tasks, and it should not prevent key officers standing in line behind the CFO from getting time with a board committee.

Rather, the board's committee structure should be informed by the process outlined, and when the fundamental compliance and EESG concerns are lined up and integrated, committees should be formed correspondingly based on board member expertise and functional purpose. For most companies,[86] this will necessitate creating at least one committee that has a critical risk management, compliance, and EESG function addressing some critical non-financial areas of concern, such as environment for an energy company or product safety for a pharmaceutical or

[86] Some companies have already understood the diversity of compliance and EESG issues they confront and have commendably created specific committees that give important elements of non-financial compliance oversight to them. For example, the board of Ashland Global—a leading chemicals company—has established an Environmental, Health, Safety and Quality Committee. Ashland Global Holdings Inc., Proxy Statement (Schedule 14A) (December 9, 2019), https://www.sec.gov/Archives/edgar/data/1674862/000119312519308787/d785067ddef14a.htm. Likewise, Citigroup has established an Ethics, Conduct and Culture Committee. Citigroup Inc., Proxy Statement (Schedule 14A) (Mar. 11, 2020), https://www.sec.gov/Archives/edgar/data/831001/000120677420000777/citi3648191-def14a.htm.

food company.[87] This allocation could also come with responsibility for attendant areas of concern, such as a concern for cybersecurity and appropriate regard for consumer privacy as to companies that collect sensitive information from their customers. Establishing such a committee would help directors to satisfy both their legal obligations under *Caremark*[88] and the nonlegal need to address EESG concerns.[89]

But in general it is, of course, important not to proliferate committees, and that is not what we are calling for. Rather, in addition to considering whether to establish a dedicated compliance/EESG committee, what also needs to be rethought is the function of some of the mandated committees, such as the compensation committee. By way of illustration, consider the areas of compliance that involve issues like worker safety, a discrimination free and tolerant workplace, and fair and equitable pay and benefits. Since they first emerged in American corporate governance, compensation committees have focused obsessively on the compensation

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[87] One size does not always fit all in corporate governance, though do not view standardization with the same degree of skepticism that some do. Leo E. Strine, Jr. & J. Travis Laster, *The Siren Song of Unlimited Contractual Freedom*, *in* RESEARCH HANDBOOK ON PARTNERSHIPS, LLCS AND ALTERNATIVE FORMS OF BUSINESS ORGANIZATIONS 11, 18 (Robert W. Hillman & Mark J. Lowenstein eds., 2015) (observing that unlimited contractual freedom can impose transaction costs due to the need for investors to evaluate unfamiliar terms in LLC and other alternative-entity governing documents); Reilly S. Steel, *Proxy Access and Optimal Standardization in Corporate Governance: An Empirical Analysis*, 23 FORDHAM J. CORP. & FIN. L. 173 (2017) (developing a theory in which investors prefer standardized terms and presenting empirical evidence consistent with that theory). It may be that there are some companies whose risk management, compliance, and EESG issues are so confined in scope that they can all be trusted to the audit committee on top of that committees' already challenging duties. We do not think many exist.

[88] *See* Marchand v. Barnhill, 212 A.3d 805, 809, 813, 817, 822 (Del. 2019) (mentioning on four separate occasions the company's lack of any committee on the board charged with addressing food safety even though the company's only product was ice cream).

[89] These nonlegal concerns may include a genuine desire on the part of directors to address EESG concerns (or satisfy investors' demands that they do so), or more cynically, merely "signaling" a commitment to EESG. *See generally* Brian L. Connelly et al., *Signaling Theory: A Review and Assessment*, 37 J. Mgmt. 39 (2011) (reviewing the literature on signaling). This raises interesting questions about whether signaling concerns might lead some boards to pursue EESG approaches that privilege visibility over efficiency. *See, e.g.*, Aneesh Raghunandan & Shiva Rajgopal, *Do the Socially Responsible Walk the Talk?* Working Paper, https://www.bus.miami.edu/_assets/pdfs/thought-leadership/academic-departments/accounting/seminars/raghunandan-rajgopal-.pdf (finding that, relative to industry peers, signatories of the Business Roundtable's new Statement of Corporate Purpose had higher rates of environmental and labor complaints and spent more money on lobbying). We leave this question to future research, noting only that boards may wish to adopt our proposed approach for either efficiency or signaling reasons. By consolidating EESG and compliance functions, our proposal serves the interests of efficiency; at the same time establishing visible committees dedicated to both EESG and compliance may signal the board's commitment to EESG.

of top management and making sure that managers' compensation is linked to gains for stockholders. They have not been focused on the company's overall human capital strategy, considering whether it would create more value to focus more on good pay for the many who toil for the company rather than the few at the top, or in overseeing the company's policies for ensuring a safe workplace, diversity, training, and fair pay and benefits for company workers, and standards required of company contractors in those are essential to workers. But, there is an increased demand for corporations to give greater consideration to these areas, as exemplified by the U.K.'s new requirement for companies to have a director elected by the workforce or a board committee that focuses on the workforce's best interests.[90] And bills in Congress show a growing interest in having worker representatives on boards,[91] an interest that may well result in focus on a workforce board committee as a solution that will have more support in the American corporate governance context. With these growing demands, boards and management will have to grapple with how to efficiently respond and whether to add a new committee, with the costs that it entails in the potential need to increase board size, the length of board members' and managers' time, and the splitting of related functions. One potentially effective answer would be to reconceive the role of the compensation committee to broaden its mandate to take on oversight responsibility for all important workforce issues. This could give directors an efficient way to oversee all key human resources policies, such as those critical to racial and gender pay equity and diversity, and also to establish the optimal approach to fair gainsharing between the

[90] The UK Corporate Governance Code (July 2018), https://www.frc.org.uk/getattachment/88bd8c45-50ea-4841-95b0-d2f4f48069a2/2018-UK-Corporate-Governance-Code-FINAL.pdf ("For engagement with the workforce, one or a combination of the following methods should be used [1] a director appointed from the workforce; [2] a formal workforce advisory panel; [or 3] a designated non-executive director").
[91] *See* sources cited *supra* note [●].

company's workforce overall, on the one hand, and its stockholders and top management, on the other.[92]

In thinking about the committee structure, skeptics might contend that it is essential that the entire board be involved in compliance, risk management, and EESG. And the answer to that is: yes, we agree. But we recognize that for the entire board to do its collective job well, there is an advantage to specialization and time on task, where you use the diverse talents of the board and management effectively to make sure that we identify all key issues, give each of them adequate time, and are therefore better able to develop and implement an overall approach that is most effective. For example, it could make sense for a board committee to have penultimate responsibility for approving the overall compliance/risk management/EESG plan before it goes to the board. That process of approval could involve presentations by other committees about key areas of concern. And likewise, if audit is the approving committee, it could require the audit committee and relevant officers to brief the other directors about their approach to financial risk and EESG subjects in that area. Cross-fertilization by a set of strong committees well populated with relevant expertise and with the time to do the job well sets up the whole board to function much better than loading too much on to the audit committee (the traditional approach)

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[92] In a related paper, two of us explain how this might work. Leo E. Strine & Kirby M. Smith, *Toward Fair Gainsharing and a Quality Workplace for Employees: How a Reconceived Compensation Committee Might Help Make Corporations More Responsible Employers and Restore Faith in American Capitalism* (Working Paper, June 16, 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3619273. Other learned commentators find this avenue promising. See Amelia Miazad, *Sex, Power, and Corporate Governance* (Forthcoming UC Davis Law Review 2020) (discussing the board's influence on culture and pointing to the compensation committee as a committee that increasingly has oversight for culture and workforce issues generally). And some companies have already done this. *See* Steve Van Putten, David Bixby & Jan Koors, *The Compensation Committee Agenda for 2019*, Harv. Law Sch. Forum on Corporate Governance (May 1, 2019), https://corpgov.law.harvard.edu/2019/05/01/the-compensation-committee-agenda-for-2019/ ("Broader-based pay issues (think CEO Pay Ratio and gender and other diversity-based pay inequities), talent development, and culture-related concerns are pushing the boundaries of traditional compensation committee responsibilities.").

or setting up a bifurcated process whereby audit does compliance and risk management, and the nominating and corporate governance committee is given some vague mandate to oversee EESG.

To the extent that establishing processes to consider EESG and compliance together has the potential to make EESG more durable, this should also appeal to those who advocate EESG as a means of redressing social inequities and other shortcomings of our legal and political system. It seems plausible that setting a routinized process for considering EESG together with compliance will more firmly embed EESG within corporate culture and governance.[93] If so, that would be a victory for EESG advocates concerned that EESG may take a back seat if it becomes less fashionable with the Davos crowd.

Conclusion

With careful thought, corporate leaders can position their companies to better identify and address known and emerging risks; adopt goals for responsible corporate behavior toward workers, other stakeholders, and society; and establish standards and policies designed to promote and measure the attainment of both EESG goals and legal compliance. This will not be easy, but it is an exercise that is long overdue for most companies and will have long-lasting value if it becomes not just a one-off restructuring, but a regular process of serious thought about how the company makes money and how it affects the world in doing so. This thought process could result in more informed business decisions, a more efficient use of the human capital of the board, management and the overall workforce, and best assure a corporate culture that seeks sustainable profit by a commitment to being good citizens. Put plainly, a well-thought-out corporate strategy to be an exemplary citizen in all the areas where the company has a material

[93] *Cf.* Donald C. Langevoort, *Cultures of Compliance*, 54 AM. CRIM. L. REV. 933 (2017) (exploring the role of culture in ensuring good compliance)

impact on its stakeholders and society should at the very least result in the corporation establishing a solid reputation as a law-abiding citizen. And that in itself is a good thing.