

Caremark and ESG, Perfect Together: A Practical Approach to Implementing an Integrated, Efficient, and Effective Caremark and EESG Strategy

Leo E. Strine, Jr.,* Kirby M. Smith** & Reilly S. Steel***

ABSTRACT: 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,

* Michael L. Wachter Distinguished Fellow in Law and Policy at the University of Pennsylvania Carey Law School; Ira M. Millstein Distinguished Senior Fellow at the Millstein Center at Columbia Law School; Senior Fellow, Harvard Program on Corporate Governance; Henry Crown Fellow, Aspen Institute; Of Counsel, Wachtell Lipton Rosen & Katz; former Chief Justice and Chancellor of the State of Delaware. This Essay was originally presented on Zoom as the Keynote Lecture for the Columbia University Law School and Deloitte Board Leadership forum on May 12, 2020.

** Associate, Wachtell, Lipton, Rosen & Katz.

*** Associate, Cravath, Swaine & Moore LLP. The authors are grateful to Xavier Briggs, Jeff Gordon, Amelia Miazad, Elizabeth Pollman, and Eric Talley for their insightful comments. The views expressed herein are solely the personal views of the authors and do not represent the views of Cravath, Swaine & Moore LLP or legal advice.

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.

I. INTRODUCTION.....	1886
II. THE ORIGINS OF TODAY'S INTENSE FOCUS ON EESG.....	1889
III. TOWARD AN INTEGRATED, EFFICIENT, AND EFFECTIVE APPROACH TO CORPORATE COMPLIANCE AND EESG.....	1905
IV. A PRACTICAL WAY TO THINK ABOUT ORGANIZING AND IMPLEMENTING AN INTEGRATIVE COMPLIANCE/EESG STRATEGY.....	1910
V. CONCLUSION	1921

I. 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 may endanger our lives and the resiliency of our critical supply chains¹ 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 sharpen the 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

1. See, e.g., Jill E. Hobbs, *Food Supply Chains During the COVID-19 Pandemic*, 68 CANADIAN J. AGRIC. ECON. 171, 173 (2020) (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 Reisinger, *Beyond Antitrust, US Justice Department Expands Its Review Into Big Tech Companies*, LAW.COM: CORPORATE COUNSEL (Nov. 18, 2019, 4:20 PM), <https://www.law.com/corpocounsel/2019/11/18/beyond-antitrust-us-justice-department-expands-its-review-into-big-tech-companies> [<https://perma.cc/U2GR-4KBQ>] (noting DOJ may investigate large technology companies' handling of consumer data).

2. See *infra* Part II.

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 act fairly toward their employees, customers, creditors, the environment, and the 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,⁶ 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 strong EESG programs and promote compliance with

3. The extra “E” for employees—a crucial but oftentimes missing component in the ESG discussion. See Leo E. Strine, Jr., *Toward Fair and Sustainable Capitalism* 6 (Roosevelt Inst., Working Paper No. 202008, 2020), https://rooseveltinstitute.org/wp-content/uploads//08/RI_TowardFairandSustainableCapitalism_WorkingPaper_202008.pdf [<https://perma.cc/69BL-P6MD>].

4. See *infra* notes 15–16 and accompanying text.

5. *In re Caremark Int’l Inc. Derivative Litig.*, 698 A.2d 959 (Del. Ch. 1996).

6. Leo E. Strine, Jr., Lawrence A. Hamermesh, R. Franklin Balotti & Jeffrey M. Gorris, *Loyalty’s Core Demand: The Defining Role of Good Faith in Corporation Law*, 98 GEO. L. REV. 629, 649–51 (2010).

law. By aiming for higher standards of conduct than the law mandates, corporations should at least do what is legally 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. This means allocation 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.⁷ 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.⁸ 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 an integrated, efficient, and effective way.

This Essay proceeds in three parts. Starting with a brief overview of the contemporary debates regarding stakeholders and EESG, Part I observes that corporate law’s first principle 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 that, as a matter of practical business strategy, 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

7. For an incisive review of this literature, see generally Elizabeth Pollman, *Corporate Social Responsibility, ESG, and Compliance*, in CAMBRIDGE HANDBOOK OF COMPLIANCE (Benjamin van Rooij & D. Daniel Sokol eds., forthcoming 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3479723 [<https://perma.cc/A5SD-8NDB>] (providing an overview of the EESG landscape in the United States and its connection to compliance).

8. Stavros Gadinis & Amelia Miazad, *Corporate Law and Social Risk*, 73 VAND. L. REV. 1401, 1458–70 (2020). Other recent work similarly proposes expanding directors’ fiduciary duties on the premise that they currently do not sufficiently penalize compliance failures. See John Armour, Jeffrey Gordon & Geeyoung Min, *Taking Compliance Seriously*, 37 YALE J. ON REGUL. 1, 49–59 (2020).

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 and legal compliance to share with stakeholders 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.

II. 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."⁹ 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 also treat society and other corporate stakeholders like workers with respect.¹⁰ In

9. E.g., Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO L.J. 439, 440 (2001) [hereinafter Hansmann & Kraakman, *End of History*]. 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, *A Friedman Doctrine—The Social Responsibility of Business Is to Increase Its Profits*, N.Y. TIMES, Sept. 13, 1970, at 32, 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, 268–70 (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, 179–84 (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, 1169–71 (2017); see also *infra* notes 17–18 and accompanying text (critiquing the shareholder primacy ideology).

10. Chancellor, later Professor, Allen summarized the historical tension between these two schools of thinking in *Our Schizophrenic Conception of the Business Corporation*. Allen, *supra* note 9, at 264–72. 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

fact, just two decades ago, two eminent scholars called this “the end of history for corporate law.”¹¹ 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.¹²

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,¹³ 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 some of America’s largest 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.¹⁴ Facing their own

understood to include an overriding obligation to operate within the law, as even Friedman understood it. See Friedman, *supra* note 9, at 32.

11. Hansmann & Kraakman, *End of History*, *supra* note 9, at 439.

12. 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 11–12 (2018), <https://rooseveltinstitute.org/wp-content/uploads/2020/07/RI-Towards-Accountable-Capitalism-brief-201810.pdf> [<https://perma.cc/NK3L-LA2Z>] (“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 rights are extensive across much of the private sector.”). It also ignored that a majority of American states had adopted so-called constituency statutes permitting boards to treat stakeholder interests with respect. Caroline Flammer & Aleksandra Kacperczyk, *The Impact of Stakeholder Orientation on Innovation: Evidence from a Natural Experiment*, 62 MGMT. SCI. 1982, 1998 (2016) (analyzing the effect of the “enactment of constituency statutes in 34 states between 1984 [and] 2006”).

13. 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, at xi (1992) (quoting Francis Fukuyama, *The End of History?*, NAT’L INT., Summer 1989, at 4).

14. BUS. ROUNDTABLE, STATEMENT ON THE PURPOSE OF A CORPORATION (Aug. 19, 2019), <https://system.businessroundtable.org/app/uploads/sites/5/2021/02/BRT-Statement-on-the-Purpose-of-a-Corporation-February-2021-compressed.pdf> [<https://perma.cc/AW3X-KVFX>] (signatures last updated February 2021). This change brought the Roundtable’s view back in line with its original view (taken in 1978), and reversed the stockholder primacy shift it made in 1997. See generally Bus. Roundtable, *The Role and Composition of the Board of Directors of the Large Publicly Owned Corporation: Statement of the Business Roundtable*, 33 BUS. LAW. 2083 (1978) (outlining its

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 at least twenty-four of the twenty-five largest U.S. corporations”¹⁵—have publicly stated that the creation of sustainable corporate profits requires companies to act fairly towards their stakeholders.¹⁶ 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.¹⁷ And a number of academics have joined the fray as well, expressing support for some version of stakeholderism.¹⁸

belief on the proper relationship between the board of directors and management in large publicly held enterprises); BUS. ROUNDTABLE, STATEMENT ON CORPORATE RESPONSIBILITY (1981) (setting forth seven recommendations for corporations to consider when evaluating their social impacts); Martin Lipton, Steven A. Rosenblum, Sabastian V. Niles, Sara J. Lewis, Kisho Watanabe & Michael Drexler, *The New Paradigm*, WORLD ECON. F. (Sept. 2, 2016), <http://www.wlrk.com/webdocs/wlrknew/AttorneyPubs/WLRK.25960.16.pdf> [<https://perma.cc/8TEW-UAP5>] (proposing a corporate governance framework meant to achieve long-term economic prosperity through collaboration).

15. John D. Morley, *Too Big to Be Activist*, 92 S. CAL. L. REV. 1407, 1409 (2019).

16. See Larry Fink, *Larry Fink's 2018 Letter to CEOs: A Sense of Purpose*, BLACKROCK, <https://www.BlackRock.com/corporate/investor-relations/2018-larry-fink-ceo-letter> [<https://perma.cc/NT9H-PKKZ>] (“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, 10:15 AM), <https://www.wsj.com/articles/bogle-sounds-a-warning-on-index-funds-1543504551> [<https://perma.cc/GBX3-244E>]; *Asset Stewardship*, STATE ST. GLOB. ADVISORS, <https://www.ssga.com/us/en/institutional/ic/capabilities/esg/asset-stewardship> [<https://perma.cc/XV8J-ZTYC>] (“State Street Global Advisors' mission is to invest responsibly in order to enable prosperity and social progress Companies embracing Environmental Social and Governance (ESG) best practice have strong, effective independent boards and incorporate sustainability into their long-term strategy across these two issues.” (emphasis omitted)); *Policies and Guidelines*, VANGUARD, <https://www.vanguard.com.au/personal/en/investment-stewardship-policies-and-guidelines/isp-tab-environmental-social-tab> [<https://perma.cc/8Z79-XME4>] (“[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 generally 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. 1007 (2020).

17. See Accountable Capitalism Act, S. 3348, 115th Cong. § 5 (2018); *Corporate Accountability and Democracy*, BERNIE, <https://bernieanders.com/issues/corporate-accountability-and-democracy> [<https://perma.cc/C9K2-GYDA>].

18. See generally COLIN MAYER, PROSPERITY: BETTER BUSINESS MAKES THE GREATER GOOD (2018) (proposing a view of corporations that includes their role in promoting economic and social wellbeing, not just shareholder profits); LYNN STOUT, THE SHAREHOLDER VALUE MYTH (2012) (advocating against shareholder primacy as a baseline assumption and for a view that better serves corporations and their stakeholders). Relatedly, academics have also paid significant attention to the rise of “passive” institutional investors, who have often supported EESG 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, 19 (2019); Dorothy S. Lund, *The Case Against Passive Shareholder Voting*, 43 J. CORP. L. 493, 494 (2018); Lucian Bebchuk & Scott Hirst, *Index*

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. Despite the fact that corporations have benefited from a ten-year economic recovery resulting in part from a government rescue of the financial sector and a substantial cut of the corporate tax rate from 35 percent to 21 percent, many corporations failed to have balance sheets with prudent reserves and were unable to weather some period of months without revenues without immediately laying off workers and failing to pay their landlords and ordinary suppliers. In part, a large number of those corporations had failed to build up those reserves because they had used substantial excess cash reserves on stock buybacks and dividends, while leaving 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 many of their jobs had failed to pay a living wage left them with no safety margin to weather the sudden job loss. 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.¹⁹

The pandemic also underscored the persistence of profound racial inequality in our economy. 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, which put them in a worse position to weather the storm.²⁰ 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

Funds and the Future of Corporate Governance: Theory, Evidence, and Policy, 119 COLUM. L. REV. 2029, 2033–34 (2019).

19. Kylie McQuarrie, *The Average Salary of Essential Workers in 2020*, BUSINESS.ORG (May 11, 2020), <https://www.business.org/finance/accounting/average-salary-of-essential-workers> [https://perma.cc/S8JD-DYV7] (reporting “the average salary for essential workers is far below the state’s average”); see also SUSAN LUND, KWEILIN ELLINGRUD, BRYAN HANCOCK, JAMES MANYIKA & ANDRÉ DUA, LIVES AND LIVELIHOODS: ASSESSING THE NEAR-TERM IMPACT OF COVID-19 ON US WORKERS 7 (2020), <https://www.mckinsey.com/~media/McKinsey/Industries/Public%20and%20Social%20Sector/Our%20Insights/Lives%20and%20livelihoods%20Assessing%20the%20near%20term%20impact%20of%20COVID%2019%20on%20US%20workers/Lives-and-livelihoods-Assessing-the-near-term-impact-of-COVID-19-on-US-workers.pdf> [https://perma.cc/HV96-RLAD] (finding that 86 percent 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).

20. See Sarah Thomason & Annette Bernhardt, *Front-line Essential Jobs in California: A Profile of Job and Worker Characteristics*, U.C. BERKELEY LAB. CTR. (May 14, 2020), <http://laborcenter.berkeley.edu/front-line-essential-jobs-in-california-a-profile-of-job-and-worker-characteristics> [https://perma.cc/BG65-APG4] (finding that “[Latinx and Black workers were most] likely to be employed in front-line essential jobs”).

processing plant, a shipping facility, or a hospital exposed them to greater risk. Making matters worse, the failure of some of these companies to keep their workers safe necessitated shutdowns, which further endangered not just their workers' continued employment, but the companies' ability to deliver their products and services and to make money.

In the wake of the pandemic, it is likely that public officials, regulators, and private plaintiffs will all take 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.²¹

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, 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 the ideology.²²

But too often lost 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 the first principle of corporate law: corporations may only conduct lawful business by lawful means.²³ It is a simple principle, but often overlooked, despite its relevance to

21. Indeed, some of these groups have already begun to demand greater accountability. *See, e.g.*, SENATORS MARK R. WARNER, BERNIE SANDERS, DOUG JONES & RICHARD BLUMENTHAL, THE PAYCHECK SECURITY ACT 3 (2020), https://www.warner.senate.gov/public/_cache/files/c/2/c295296f-ec7a-44ab-80a6-716efed4fac7/C39D4FA1736189594F4C99B5FA5868AD.paycheck-security-act-summary.pdf [<https://perma.cc/N3PK-ARMU>] (proposing to amend the CARES Act so that companies receiving bailout funds are prohibited from buying back stock, must stay neutral during union organizing efforts, and must cap CEO pay at 50 times the median wage of the company's workforce); Pandemic Anti-Monopoly Act of 2020, H.R. 6989, 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 M. Cuomo, *Let's Not Repeat the Mistake of Putting Corporations Ahead of Workers in a Crisis*, WASH. POST (May 13, 2020, 7:58 AM), <https://www.washingtonpost.com/opinions/2020/05/13/andrew-cuomo-what-washington-must-do-protect-workers> [<https://perma.cc/48QL-ZD4B>] (advocating that "[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").

22. *See generally* Lucian A. Bebchuk & Roberto Tallarita, *The Illusory Promise of Stakeholder Governance*, 106 CORNELL L. REV. 91 (2020) (arguing that recent corporate movement toward "stakeholderism" should not be expected to produce real change and that "stakeholderism," in fact, delays meaningful reform); *see also* Press Release, Council of Institutional Invs., Council of Institutional Investors Responds to Business Roundtable Statement on Corporate Purpose (Aug. 19, 2019), https://www.cii.org/aug19_brt_response [<https://perma.cc/YJ3-EAU5>].

23. DEL. CODE ANN. tit. 8, § 101(b) (2020) ("A corporation may be incorporated or organized under this chapter to conduct or promote any lawful business or purposes. . . ."); MODEL BUS. CORP. ACT § 3.01(a) (AM. BAR ASS'N 2016) ("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.*,

today's debate about stakeholderism and whether corporations and other business entities are acting in a sufficiently responsible and sustainable manner. It also adds at least one important caveat to the notion that corporate law makes "stockholder wealth maximization" (or even "stockholder welfare maximization")²⁴ the fundamental end of corporate law.

This principle may seem mundane, but that does not undermine its importance. Under flexible chartering statutes, corporations are 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 also be lawful.

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 for above-board conduct, for acting in a manner that does not skirt the law and that

No. 5430, 2011 WL 2176479, at *20 (Del. Ch. May 31, 2011) ("Delaware law 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 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 Comm'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 (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 the intent to violate applicable positive law . . ." (quoting *In re Walt Disney Co. Derivative Litig.*, 907 A.2d 693, 755 (Del. Ch. 2005))).

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

25. See, e.g., tit. 8, § 101 (b) ("A corporation may be incorporated or organized under this chapter to conduct or promote any lawful business or purposes, except as may otherwise be provided by the Constitution or other law of this State.").

26. See STOUT, *supra* note 18, at 30–31 (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, 761 (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, 710–11 (2019).

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 viewed as 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; there should be just one integrated scheme.

The reasons why are easy to grasp if one thinks 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

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, Inc. v. Newmark*, 16 A.3d 1, 33 (Del. Ch. 2010) ("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, 780–81 (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. 631, 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* note 22, at 117 tbl.1 (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 *Newmark*, 16 A.3d at 32–35 (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, 182 (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.").

society.²⁹ One 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.³⁰

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.³¹ In his decision, Chancellor Allen observed that:

[C]orporate 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.³²

Caremark and other developments, such as the federal sentencing guidelines,³³ 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,³⁴ scholars have

29. William W. Bratton, Jr., *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 from the conduct of business."); 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* (2018) (examining the role of government in constituting the corporation).

30. For a durably valuable account of the role of organizational law in not only providing limited liability to owners, but also "shielding of the assets of the entity from claims of the creditors of the entity's owners," see Henry Hansmann & Reinier Kraakman, *The Essential Role of Organizational Law*, 110 YALE L.J. 387, 390 (2000).

31. *In re Caremark Int'l Inc. Derivative Litig.*, 698 A.2d 959, 971 (Del. Ch. 1996).

32. *Id.* at 970.

33. See U.S. SENT'G GUIDELINES MANUAL § 8B2.1(a)(1)–(2) (U.S. SENT'G COMM'N 2018) (outlining the necessary requirements for a corporation "[t]o have an effective compliance and ethics program" including "exercis[ing] due diligence to prevent and detect criminal conduct" and "promot[ing] an organizational culture that encourages ethical conduct and a commitment to compliance with the law").

34. *Stone ex rel. AmSouth Bancorporation 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.'" (quoting *In re Caremark*, 698 A.2d at 967)); *Guttman v. Huang*, 823 A.2d 492, 505–06 (Del. Ch.

viewed the case as having enormous value in encouraging more intensive diligence in the area of compliance,³⁵ amplified by substantial government penalties on corporations that run afoul of the law with weak compliance programs.³⁶ Indeed, despite the fact that *Caremark* cases rarely result in legal liability,³⁷ leading corporate counsel regularly remind directors of this duty.³⁸ And recent *Caremark* decisions denying the defendants' motions to dismiss have resulted in renewed attention to directors' oversight obligations.³⁹

In response to a series of major accounting scandals and a 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.⁴⁰ In particular, lawmakers focused on the

2003) ("A *Caremark* claim is a difficult one to prove."); *In re Caremark*, 698 A.2d at 967 ("The theory here advanced is possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment.").

35. Donald C. Langevoort, Commentary, *Caremark and Compliance: A Twenty-Year Lookback*, 90 TEMP. 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 B.C. 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." (footnote omitted)).

36. 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 generally Jennifer Arlen & Reinier Kraakman, *Controlling Corporate Misconduct: An Analysis of Corporate Liability Regimes*, 72 N.Y.U. L. REV. 687 (1997).

37. 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." (footnotes omitted)).

38. See Robert C. Bird, *Caremark Compliance for the Next Twenty-Five Years*, 58 AM. BUS. L.J. 63, 86–102, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3566279 [<https://perma.cc/AD4J-3ESN>] (analyzing twenty-four law firm client memos on the Delaware Supreme Court's decision in *Marchand v. Barnhill*).

39. See *Marchand v. Barnhill*, 212 A.3d 805, 807–09 (Del. 2019) (reversing the denial of a motion to dismiss in the food safety context); *In re Clovis Oncology, Inc. Derivative Litig.*, No. 2017-0222, 2019 WL 4850188, at *10 (Del. Ch. Oct. 1, 2019) (denying motion to dismiss in the pharmaceutical regulatory approval context); *Hughes v. Xiaoming Hu*, No. 2019-0112, 2020 WL 1987029, at *1 (Del. Ch. Apr. 27, 2020) (financial reporting and oversight context); *Inter-Marketing Grp. USA, Inc. ex rel. Plains All Am. Pipeline, L.P. v. Armstrong*, No. 2017-0030, 2020 WL 756965, at *1 (Del. Ch. Jan. 31, 2020) (environmental compliance); *In re McKesson Corp. Derivative Litig.*, No. 17-cv-01850, 2018 WL 2197548, at *1 (N.D. Cal. May 14, 2018) (controlled substance compliance).

40. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 301, 116 Stat. 745, 775–76 (codified as 15 U.S.C. § 78j-1 (2018) (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 § 303A.07 (2021) (outlining "the

independence of the audit committee and its advisors,⁴¹ as well as that of the compensation committee.⁴²

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 marginal traders and activist hedge funds.⁴³ Staggered boards have become largely extinct at the biggest companies;⁴⁴ activist investors have used “withhold” votes to intimidate independent directors;⁴⁵ and proxy contests

requirements for independence”); NASDAQ STOCK MARKET RULEBOOK § 5605(c)(2)(A) (2021) (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”).

41. See Sarbanes-Oxley Act §§ 201–09; NYSE LISTED COMPANY MANUAL § 303A.07; NASDAQ STOCK MARKET RULEBOOK § 5605(c)(2)(A).

42. See Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 952, 124 Stat. 1376, 1900–03 (2010) (codified as amended at 15 U.S.C. § 78j-3 (2018)).

43. 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, “can 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 Reevaluation 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 STRATEGIC MGMT. J. 1054, 1056–57 (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 R. Stubben, *Board of Directors’ Responsiveness to Shareholders: Evidence from Shareholder Proposals*, 16 J. CORP. FIN. 53, 54 (2010) (finding that directors who adopt shareholder proposals supported by a majority of shareholders experience a 20 percent reduction in their likelihood of losing their board seat or other director positions).

44. See KOSMAS PAPADOPOULOS, ROBERT KALB, ANGELICA VALDERRAMA & JARED SORHAINDO, INSTITUTIONAL S’HOLDER SERVS., U.S. BOARD STUDY: BOARD ACCOUNTABILITY PRACTICES REVIEW 5 (2018), <https://www.issgovernance.com/file/publications/board-accountability-practices-review-2018.pdf> [<https://perma.cc/E374-BC8V>] [hereinafter, PAPADOPOULOS ET AL., BOARD STUDY] (noting the proportion of S&P 500 companies that elect directors annually grew from 59 percent in 2009 to 87 percent in 2017).

45. See Yonca Ertimur, Fabrizio Ferri & David Oesch, *Understanding Uncontested Director Elections*, 64 MGMT. SCI. 3400, 3400–02 (2018) (documenting empirically that shareholder withhold votes affect how boards and companies operate); PAPADOPOULOS ET AL., BOARD STUDY, *supra* note 44, at 6–7 (noting the proportion of S&P 500 companies that use majority voting grew from 59 percent in 2009 to 92 percent in 2017).

and pressure campaigns have grown not only in frequency, but in their rate of success.⁴⁶

Not coincidentally, this period has 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, many stockholder initiatives have focused on making companies more, rather than less, responsive to immediate market pressures and paid little to no attention to issues like risk management.⁴⁷ Governance rules have moved strongly in the direction institutional investors prefer and corporate directors regularly face mini-referendums in which investors could express their dismay over any current adverse development.⁴⁸ And using the many

46. 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 percent from 2016. *See* SULLIVAN & CROMWELL LLP, REVIEW AND ANALYSIS OF 2019 U.S. SHAREHOLDER ACTIVISM 15 (2019), <https://www.sullcrom.com/siteFiles/Publications/2019ShareholderActivismAnnualReport.pdf> [<https://perma.cc/6LCZ-ETFU>].

47. *See generally* PAPADOPOULOS ET AL., BOARD STUDY, *supra* note 44 (documenting the changes in governance at S&P Composite 1500 companies from 2009 to 2017).

48. *See id.*; *see also* Fang Chen, Lijing Du, Susan M.V. Flaherty, Jian Huang & Gokhan Torna, *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, *The Long View: The Role of Shareholder Proposals in Shaping U.S. Corporate Governance (2000-2018)*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Feb. 6, 2019), <https://corpgov.law.harvard.edu/2019/02/06/the-long-view-the-role-of-shareholder-proposals-in-shaping-u-s-corporate-governance-2000-2018> [<https://perma.cc/QK93-4KCZ>] (documenting the role of shareholder proposals in changing U.S. corporate governance). *See generally* Stephen J. Choi, Jill E. Fisch, Marcel Kahan & Edward B. Rock, *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* SULLIVAN & CROMWELL LLP, 2019 PROXY SEASON REVIEW: PART 2, at 7–8 (2019), <https://www.sullcrom.com/files/upload/SC-Publication-2019>

tools they were given to pressure management, activist investors, aided by other institutional investors, have pushed companies to deliver immediate returns, at the risk of being ousted from office or otherwise publicly embarrassed.⁴⁹

This new dynamic has led naturally to an intense corporate focus 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 profitability and productivity between employees (in the form of salary increases) and stockholders (in the form of dividends and other returns) has markedly tilted toward stockholders and top corporate management.⁵⁰ This tilt has

Proxy-Season-Review-Part-2-ISS-Negative-Recommendations-Against-Directors.pdf [https://perma.cc/W7HM-FWCJ].

49. See Christopher Whittall, *Activist Investors Are Spending More and Shifting Their Strategies*, WALL ST. J. (Dec. 6, 2018, 8:00 AM), <https://www.wsj.com/articles/activist-investors-are-spending-more-and-shifting-their-strategies-1544101200> [https://perma.cc/CP3N-5JZJ] (“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 43, 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.”).

50. 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 H. Summers, *The Declining Worker Power Hypothesis: An Explanation for the Recent Evolution of the American Economy*, BROOKINGS PAPERS ON ECON. ACTIVITY 1, 63–65 (Mar. 18, 2020), <https://www.brookings.edu/wp-content/uploads/2020/12/StansburySummers-Final-web.pdf> [https://perma.cc/6NWB-99K8] (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 generally Frank Levy & Peter Temin, *Inequality and Institutions in 20th Century America* (Indus. Performance Ctr., Mass. Inst. Tech. Working Paper Series, Paper No. MIT-IPC-07-002, 2007), <https://ipc.mit.edu/sites/default/files/2019-01/07-002.pdf> [https://perma.cc/RRU4-LB9Q] (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 percent, while workers’ wages grew by 93.2 percent. *The Productivity-Pay Gap*, ECON. POL’Y INST. (July 2019), <https://www.epi.org/productivity-pay-gap> [https://perma.cc/B34L-4WH4]. 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 *id.* Likewise, during this period, senior executives were compensated much better than the

contributed to greater inequality and growing economic insecurity and dissatisfaction.⁵¹ Likewise, some observers have expressed concern that the avid pursuit of stock market gains has led corporations to be insensitive (or worse) to the long-term consequences of their conduct for the planet's health and the health and welfare of their consumers.⁵²

average worker, but not by an astronomical amount. LAWRENCE MISHEL & JULIA WOLFE, ECON. POL'Y INST., CEO COMPENSATION HAS GROWN 940% SINCE 1978: TYPICAL WORKER COMPENSATION HAS RISEN ONLY 12% DURING THAT TIME 3 (2019), <https://www.epi.org/files/pdf/171191.pdf> [<https://perma.cc/F68Q-NZRY>] (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 percent, but the wealth created by these productivity gains went predominately to executives and stockholders, with worker pay rising by only 11.6 percent during this period, while CEO compensation grew by 940 percent. *The Productivity-Pay Gap*, *supra*; MISHEL & WOLFE, *supra*. That is, over the past 40 years, increases in societal wealth have primarily benefited the stockholders, not workers. See MICHAEL T. OWYANG & HANNAH G. SHELL, ECON. SYNOPSIS, TAKING STOCK: INCOME INEQUALITY AND THE STOCK MARKET 1–2 (2016), <https://files.stlouisfed.org/files/htdocs/publications/economic-synopses/2016-04-29/taking-stock-income-inequality-and-the-stock-market.pdf> [<https://perma.cc/7N-V6-52AX>] (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").

51. See generally THOMAS PIKETTY, CAPITAL IN THE TWENTY-FIRST CENTURY (Arthur Goldhammer, trans., 2014) (documenting growing inequality throughout the United States and other OECD countries); Thomas Piketty & Emmanuel Saez, *Income Inequality in the United States, 1913-1998*, 118 Q.J. ECON. 1 (2003) (same). Growing inequality has resulted, in part, in increased economic instability. See generally Austin Nichols & 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. 16, 2020) <https://www.newyorker.com/magazine/2020/03/23/why-americans-are-dying-from-despair> [<https://perma.cc/Xg32-F9BP>] (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 [would] grow up to be better off financially than their parents." BRUCE STOKES, PEW RSCH. CTR., GLOBAL PUBLICS MORE UPBEAT ABOUT THE ECONOMY 15 (2017), <https://www.pewresearch.org/global/2017/06/05/2-public-divided-on-prospects-for-the-next-generation> [<https://perma.cc/7XE4-TJR7>].

52. 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 be discovered over the long term. See e.g., Henry M. Paulson Jr., *Short-Termism and the Threat from Climate Change*, MCKINSEY & CO. (Apr. 1, 2015), <https://www.mckinsey.com/business-functions/strategy-and-corporate-finance/our-insights/short-termism-and-the-threat-from-climate-change> [<https://perma.cc/J8A4-GJF3>]; see Jamie Dimon & Warren E. Buffett, *Short-Termism Is Harming the Economy*, WALL ST. J.: OPINION (June 6, 2018, 10:00 PM), <https://www.wsj.com/articles/short-termism-is-harming-the-economy-1528336801> [<https://perma.cc/Z2SM-QP64>]. See generally Magali A. Delmas, Nicholas Nairn-Birch & Jinghui Lim, *Dynamics of Environmental and Financial Performance: The Case of Greenhouse Gas Emissions*, 28 ORG. & ENV'T 374 (2015) (observing that companies who adopt environmentally

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 has begun 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.⁵³ 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 and consume products and services, they are not served by a corporate governance system that encourages gimmicks, pricing bubbles, or externality risk.⁵⁴

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.⁵⁵ But, other areas

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).

53. BLACKROCK, BLACKROCK INVESTMENT STEWARDSHIP: 2018 ANNUAL REPORT 1 (2018), <https://www.blackrock.com/corporate/literature/publication/blk-annual-stewardship-report-2018.pdf> [<https://perma.cc/G4YJ-R3KZ>] (“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.”); *Principles and Policies: Responsible Investment Policy*, VANGUARD, <https://about.vanguard.com/investment-stewardship/principles-policies> [<https://perma.cc/EGW3-JUML>] (highlighting that “Vanguard supports responsible investment by: . . . [a]dvocating for responsible corporate governance . . . as a driver of long-term value creation [and] [a]cting on material environmental, social, and governance (ESG) opportunities or risks in our investments”); STATE ST. GLOB. ADVISORS, *supra* note 16; *About Us*, FID. INT’L (Dec. 31, 2020), <https://fidelityinternational.com/about-us> [<https://perma.cc/HJ58-54EP>] (announcing that Fidelity “think[s] generationally and invest[s] for the long term”).

54. See generally 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); Strine, *supra* note 3 (proposing to reform our corporate governance system so that it more closely aligns with the economic interests of American worker-investors).

55. 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, *2019 Person of the Year: Greta Thunberg*, TIME, <https://time.com/person-of-the-year-2019-greta-thunberg> [<https://perma.cc/E687-MU5U>]. 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, *Larry Fink’s 2020 Letter to CEOs: A Fundamental Reshaping of Finance*, BLACKROCK, <https://www.blackrock.com/corporate/investor-relations/2020-larry-fink-ceo-letter> [<https://perma.cc/R83W-WRRR>]. 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. *Record 631 Institutional Investors Managing More than \$37 Trillion in Assets Urge Governments to Step Up Ambition to Tackle*

of social impact also have 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.⁵⁶ Largely left out of this early stage of the ESG movement has been 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 has become too hard to totally ignore. Among policymakers, there is a growing interest in the co-determination model,⁵⁷ 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.⁵⁸ 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.”⁵⁹

Global Climate Crisis, CERES (Dec. 9, 2019), <https://www.ceres.org/news-center/press-releases/record-631-institutional-investors-managing-more-37-trillion-assets-urge> [<https://perma.cc/4ZXM-ESRL>]. Companies are responding to this pressure. See Steven Mufson, *More U.S. Businesses Making Changes in Response to Climate Concerns*, WASH. POST (June 11, 2019, 6:30 AM), https://www.washingtonpost.com/climate-environment/more-us-businesses-making-changes-in-respons-e-climate-concerns/2019/06/10/a30c86ac-8944-11e9-98c1-e945ae5db8fb_story.html [<https://perma.cc/U9TZ-BB5Q>].

56. See, e.g., Jack Nicas, Karen Weise & Mike Isaac, *How Each Big Tech Company May Be Targeted by Regulators*, N.Y. TIMES (June 23, 2020), <https://www.nytimes.com/2019/09/08/technology/antitrust-amazon-apple-facebook-google.html> [<https://perma.cc/JW7F-4WX7>]; 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> [<https://perma.cc/GQ5A-52WL>]; Elizabeth Warren, *Here's How We Can Break up Big Tech*, TEAM WARREN (Mar. 8, 2019), <https://medium.com/@teamwarren/heres-how-we-can-break-up-big-tech-gadgdeoda324c> [<https://perma.cc/BWL7-RK9F>]; Audrey Wilson, *European Union Unveils Proposed Tech Rules*, FOREIGN POL'Y (Feb. 19, 2020, 4:00 AM), <https://foreignpolicy.com/2020/02/19/european-union-digital-strategy-proposed-tech-rules-regulation-artificial-intelligence-vestager-zuckerberg-facebook-google-apple-competition-brussels> [<https://perma.cc/ZQ5T-P5YV>]; Matina Stevis-Gridneff, *E.U.'s New Digital Czar: 'Most Powerful Regulator of Big 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> [<https://perma.cc/QRV2-9XK3>].

57. See Accountable Capitalism Act, S. 3348, 115th Cong. § 6 (2018) (requiring the SEC, in consultation with the NLRB, to issue a rule that would mandate that at least 40 percent of a company's board of directors is elected by the company's employees); Reward Work Act, S. 915, 116th Cong. § 3 (2019) (requiring at least one third of directors to be elected by employees); BERNIE, *supra* note 17 (proposing that 45 percent of directors be elected by workers).

58. FIN. REPORTING COUNCIL, THE UK CORPORATE GOVERNANCE CODE 5 (2018), <https://www.frc.org.uk/getattachment/88bd8c45-50ea-4841-95bo-d2f4f48069a2/2018-UK-Corporate-Governance-Code-FINAL.pdf> [<https://perma.cc/P4HG-BNMJ>] (“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.” (footnote omitted)).

59. Some commentators and market participants have lumped employees into the “social” prong of ESG. See, e.g., *What is the “S” in ESG?*, S&P GLOB. (Feb. 24, 2020), <https://www.spglobal.com/en/research-insights/articles/what-is-the-s-in-esg> [<https://perma.cc/64SE-LTXF>] (noting that “[s]ocial factors to consider in sustainable investing include a company's strengths and

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."⁶⁰ One need not be convinced that this statement reflects a genuine commitment to stakeholder governance or improved corporate practices to recognize that the statement was not lightly made. Genuine or not, it reflects recognition by the most influential business leaders that more is expected of them, and that if they do 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.⁶¹ 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

weaknesses in dealing with social trends, *labor*, and politics" (emphasis added)); *ESG Integration*, BLACKROCK, <https://www.blackrock.com/institutions/en-us/solutions/sustainable-investing/esg-integration> [<https://perma.cc/98WH-NBYW>] ("Social (S) [i]ncludes labour issues and product liability, risks such as data security, and stakeholder opposition."); *ESG Investing: Discover Funds that Reflect What Matters Most to You*, VANGUARD, <https://investor.vanguard.com/investing/esg> [<https://perma.cc/7G5N-4NCY>] ("Social [includes] [r]elationships with employees, suppliers, clients & communities.").

60. BUS. ROUNDTABLE, STATEMENT ON THE PURPOSE OF A CORPORATION, *supra* note 14.

61. See, e.g., Hannah Zhang, *Dick's Sporting Goods Will Stop Selling Guns at 440 More Stores*, CNN BUS. (Mar. 10, 2020, 1:25 PM), <https://www.cnn.com/2020/03/10/business/dicks-sporting-goods-remove-guns-from-440-stores/index.html> [<https://perma.cc/B7RY-UHBS>] (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*, CNBC (Jan. 23, 2020, 5:57 PM), <https://www.cnbc.com/2020/01/23/goldman-wont-take-companies-public-that-dont-have-at-least-one-diverse-board-candidate-ceo-says.html> [<https://perma.cc/8BKA-HJSD>] (indicating that 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*, MICROSOFT: OFF. MICROSOFT BLOG (Jan. 16, 2020), <https://blogs.microsoft.com/blog/2020/01/16/microsoft-will-be-carbon-negative-by-2030> [<https://perma.cc/PD7X-632V>] (announcing that Microsoft will decrease its carbon emission to below zero by 2030).

becomes another add-on to a list of already difficult-to-accomplish checklist items, the proponents of greater corporate social responsibility, i.e., EESG, will fail to achieve their worthy purpose. We next turn to the task of avoiding this wasteful and harmful outcome.

III. TOWARD AN INTEGRATED, EFFICIENT, AND EFFECTIVE APPROACH TO CORPORATE COMPLIANCE AND EESG

Given the tendency in the corporate governance debates of the last 50 years toward generating new buzzwords reflecting ever-shifting sentiments for corporations to focus on new, or slightly different, concerns, we understand the impulse toward eye-rolling and cynicism over the push for EESG. But we are optimistic about EESG for two reasons. First, the demand that corporations treat stakeholders and society with respect is not a whim; it is a fundamentally critical function of every important social institution.⁶² 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 a corporation already maintains a thorough and thoughtful compliance policy, the corporation has 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 focus of corporate compliance programs.⁶³ This growing focus on climate change and other negative effects of intensive economic activity on the environment has manifested itself in

62. For a comprehensive historical argument to this effect, see generally MAYER, *supra* note 18 (laying out a stakeholder vision of business, with a focus on the corporate commitment to both customers and communities).

63. 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).

litigation under *Caremark*.⁶⁴ Corporate compliance programs that effectively addressed these environmental risks have thus better-positioned their companies to confront emerging demands to meet the “environmental” prong of EESG for action going beyond the legal minimum.

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,⁶⁵ it also overlaps with compliance. Many *Caremark* cases and regulatory actions have focused on corporations that engaged in allegedly deceptive or otherwise wrongful behavior that exposed consumers to financial harm,⁶⁶ unsafe products,⁶⁷ or theft of

64. See *City of Birmingham Ret. & Relief Sys. v. Good*, 177 A.3d 47, 50 (Del. 2017) (involving *Caremark* claims based on “nine misdemeanor criminal violations of the Federal Clean Water Act”); *Inter-Marketing Grp. USA, Inc. ex rel. Plains All Am. Pipeline, L.P. v. Armstrong*, No. 2017-0030, 2020 WL 756965, at *10–15 (Del. Ch. Jan. 31, 2020) (discussing alleged oversight claims based on liabilities resulting from an oil spill); *In re Massey Energy Co.*, No. 5430, 2011 WL 2176479, at *18–21 (Del. Ch. May 31, 2011) (discussing alleged *Caremark* violations stemming from a mine explosion and associated violations of mine safety and environmental laws); *Mercier ex rel. Massey Energy Co. v. Blankenship*, 662 F. Supp. 2d 562, 571–72, 575–76 (S.D. W. Va. 2009) (similar).

65. See BANK OF AM. MERRILL LYNCH, EQUITY STRATEGY FOCUS POINT 15 (2016), https://www.iccr.org/sites/default/files/page_attachments/equitystrategyfocuspoint_esg.pdf [<https://perma.cc/6BC6-SGAG>] (noting that part of the “S” in “ESG” includes “a company’s capacity to generate trust and loyalty with its workforce, customers and society”).

66. See *Shaev v. Baker*, No.16-cv-05541, 2017 WL 1735573, at *9–15 (N.D. Cal. May 4, 2017) (examining a *Caremark* claim based on allegations involving Wells Fargo’s account fraud scandal); *In re PayPal Holdings, Inc. S’holder Derivative Litig.*, No. 17-cv-00162, 2018 WL 466527, at *6 (N.D. Cal. Jan. 18, 2018) (involving *Caremark* claim based on alleged violations of consumer financial protection and privacy laws); *Rojas ex rel. J.C. Penney Co. v. Ellison*, No. 2018-0755, 2019 WL 3408812, at *1 (Del. Ch. July 29, 2019) (discussing allegations that 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) (examining a *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, 505–07 (S.D.N.Y. 2014) (involving a claim based on alleged failure to oversee company’s mortgage-servicing operations).

67. See, e.g., *Marchand v. Barnhill*, 212 A.3d 805, 807 (Del. 2019) (discussing alleged *Caremark* claim based on food safety violations); *Hutton v. McDaniel*, 264 F. Supp. 3d 996, 1010 (D. Ariz. 2017) (same); *In re Abbott Lab’s Derivative S’holders Litig.*, 325 F.3d 795, 808–09 (7th Cir. 2003) (discussing alleged *Caremark* claim based on failure to oversee compliance with medical device safety regulations); *In re Gen. Motors Co. Derivative Litig.*, No. 9627, 2015 WL 3958724, at *1 (Del. Ch. June 26, 2015) (discussing allegations that company’s board and management were liable under *Caremark* due to faulty ignition switches leading to personal injury and death to drivers), *aff’d sub nom. In re Gen. Motors Co. Derivative Litig.*, 133 A.3d 971 (Del. 2016); *Salsitz v. Nasser*, 208 F.R.D. 589, 590 (E.D. Mich. 2002) (discussing allegations that company’s board and management recklessly allowed “Bridgestone/Firestone tires [to be installed] on Explorer vehicles, even though the tires made the Explorer prone to instability and rollovers”); *In re TASER Int’l S’holder Derivative Litig.*, No. CV-05-123, 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).

personal data.⁶⁸ Again, corporate risk aversion and law compliance efforts under *Caremark* better position companies to address these demands for EESG policies that ensure consumer protection.

Similarly, the responsibility to provide employees with safe working conditions,⁶⁹ an environment that is tolerant toward diverse beliefs and backgrounds,⁷⁰ and fair wages and benefits,⁷¹ overlaps with important compliance duties. As with other EESG factors, the employee factor has also been a focus of *Caremark* cases and actions by regulators.⁷²

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 aimed at 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 through 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.⁷³

68. See *Corp. Risk Holdings LLC v. Rowlands*, No. 17-CV-5225, 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, Inc. S'holder Derivative Litig.*, 223 F. Supp. 3d 1317, 1320–21, 1325–26 (N.D. Ga. 2016) (same); *Palkon v. Holmes*, No. 14-CV-01234, 2014 WL 5341880, at *1 (D.N.J. Oct. 20, 2014) (same).

69. See generally Occupational Safety and Health Act of 1970, Pub. L. 91-596, 84 Stat. 1590 (ensuring safe working conditions).

70. See generally Civil Rights Act of 1964, Pub. L. 88-352, 78 Stat. 241 (prohibiting discrimination on the basis of race, color, religion, sex, or national origin).

71. See generally Fair Labor Standards Act of 1938, 29 U.S.C. § 201–262 (2018) (establishing fair labor standards).

72. See *In re Am. Apparel, Inc. 2014 Derivative S'holder Litig.*, No. CV-14-05230, 2015 WL 12724070, at *2–4, 16–17 (C.D. Cal. Apr. 28, 2015) (*Caremark* claim based on founder and CEO's alleged sexual misconduct toward company employees); *In re FedEx Corp. S'holder Derivative Litig.*, No. 08-2284, 2009 WL 10700362, at *11 (W.D. Tenn. July 30, 2009) (*Caremark* claim based on alleged misclassification of company employees as independent contractors); *In re Massey Energy Co.*, No. 5430, 2011 WL 2176479, at *18–21 (Del. Ch. May 31, 2011) (*Caremark* claim based on mine safety violations); *In re Hecla Mining Co. Derivative S'holder Litig.*, Nos. 12-CV-00097, 12-CV-00098, 12-CV-000119, 2014 WL 689036, at *9 (D. Idaho Feb. 20, 2014) (same); *Mercier ex rel. Massey Energy Co. 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).

73. See, e.g., *In re McKesson Corp. Derivative Litig.*, No. 17-cv-01850, 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 fail[ure] . . . to [properly] implement a Controlled Substance Monitoring Program”); *In re SFBC Int'l, Inc. Sec. & 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

The overlap between compliance and EESG is understandable and unremarkable when considered from this perspective. Perhaps the most important foundational question corporate directors and managers need to be able to answer to be an effective fiduciary is this one: “How does the company make money?”⁷⁴

The reason why this simple question is powerful is that it forces directors 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 company’s products and how they’re made. Doing so necessarily requires one to think about who will use the product and for what purposes, and the corresponding benefits and risks of doing so. Answering that question requires directors to think about the corporation’s production processes and who they affect and in what manner. This includes the safety of their workers and the environmental impact of the business.

The same is also true when asking how the product gets sold. What are the marketing practices that the company uses? Does the corporation gather more consumer information than necessary to make the sale? Is the company reselling that information to others? Is the corporation telling its consumers that it does so? Is the company protecting customers’ data?

Permeating the question of how the corporation makes 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? Does the company pay them fairly and give them quality benefits? Is the company keeping workers

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.*, No. 12-cv-4041, 2015 WL 13375767, at *2–3, *8 (W.D. Ark. Apr. 3, 2015) (same); *Midwestern Teamsters Pension Tr. Fund v. Baker Hughes Inc.*, No. H-08-1809, 2009 WL 6799492, at *1, *6 (S.D. Tex. May 7, 2009) (same); *Strong ex rel. Tidewater, Inc. v. Taylor*, 877 F. Supp. 2d 433, 439–40, 448–49 (E.D. La. 2012) (same); *In re Clovis Oncology, Inc. Derivative Litig.*, No. 2017-0222, 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*, No. 16-62028, 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 ex rel. Career Educ. Corp. v. McCullough*, No. 11-CV-9119, 2012 WL 3488442, at *6, *8 (N.D. Ill. Aug. 13, 2012) (similar); *Stone ex rel. AmSouth Bancorporation v. Ritter*, 911 A.2d 362, 364–65 (Del. 2006) (*Caremark* claim based on Bank Secrecy Act and anti-money-laundering violations).

74. Leo E. Strine, Jr., *Warning—Potential Danger Ahead!*, DIRS. & BDS., Third Quarter 2004, at 25, 29 (“[T]he first question you must be able to answer before you can serve responsibly as a director: How does the company make money?”).

at a “full-time part-time” hour level to avoid giving them benefits?⁷⁵ Is the corporation using contracted labor? Does the company require its contractors to extend to their employees the same standards the company requires for treatment of the company’s own employees? To what extent does the company attribute its success to its workforce as a whole as opposed to just top management? And is the company matching that thinking to the company’s compensation system?

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 the 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 the pressures on particular companies to implement more ambitious EESG standards and practices likely coincide with the areas of company operations that have the most impact on particular stakeholders and society.

Therefore, by analyzing in a rigorous way how a company makes money, and the impact that has on others, directors will be well positioned to 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 directors are seeking to go beyond the legal minimum and to treat all the corporation’s stakeholders and communities of impact in an ethical and considerate manner, the corporation is by definition minimizing the risk of breaking the law. By trying to engage in EESG best practices, the corporation will have a margin of error that keeps it largely out of the legal grey and create a reputation that will serve the company well with its stakeholders and regulators when there is a situational lapse.

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

Unfortunately, for too many companies, their existing board compliance structures are not well thought out. This may result in an imbalanced approach to legal compliance and risk management that hazards failing to

75. That is, a workload that approaches full time but stops just short of the hours necessary to trigger mandatory legal protections for employees, such as the Affordable Care Act’s employer mandate for healthcare coverage. See generally *Employer Shared Responsibility Provisions*, IRS (Dec. 29, 2020), <https://www.irs.gov/affordable-care-act/employers/employer-shared-responsibility-provisions> [<https://perma.cc/3KYE-EFYL>] (explaining the Affordable Care Act’s employer shared responsibility provisions).

identify and address key areas where the company could negatively affect stakeholders and society—and run afoul of the law.

IV. A PRACTICAL WAY TO THINK ABOUT ORGANIZING AND IMPLEMENTING AN INTEGRATIVE COMPLIANCE/EESG STRATEGY

For a public company seeking to do better and to reorganize its 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, one might say, does this mean that the board and management should investigate every source of cash flow? No. They must use their business judgment, which to us implies that they should 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 is, the more intolerant the company should be 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. For immaterial business lines, the reputational costs are more likely to outweigh the profits generated from the business.

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 performance measurement standards for both compliance and EESG.

The results of these related inquiries should then be integrated. By way of example, consider the environmental "E." For each material line of business, the company should consider the constraining regulatory regimes, 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 fidelity to higher standards 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 compliance with that

standard 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.⁷⁶ Likewise, OSHA requires documenting and reporting on workplace hazards and safety.⁷⁷ 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 best practices for 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.⁷⁸

That said, there is a current challenge that cannot be ignored: the proliferation of different approaches to EESG reporting.⁷⁹ This proliferation

76. See 21 C.F.R. § 314.80(c) (2020).

77. See 29 C.F.R. § 1904.0 (2020).

78. 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. See generally SUSTAINABILITY ACCT. STANDARDS BD., BIOTECHNOLOGY & PHARMACEUTICALS (2018), https://www.sasb.org/wp-content/uploads/2018/11/Biotechnology_Pharmaceuticals_Standard_2018.pdf [<https://perma.cc/6GBR-ZL4N>] (describing industry standards for biotechnology and pharmaceuticals). 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. See generally SUSTAINABILITY ACCT. STANDARDS BD., OIL & GAS – EXPLORATION & PRODUCTION (2018), https://www.sasb.org/wp-content/uploads/2018/11/Oil_Gas_Exploration_Production_Standard_2018.pdf [<https://perma.cc/V2XY-8DSJ>] (describing industry standards for oil and gas); WORLD ECON. F., TOWARD COMMON METRICS AND CONSISTENT REPORTING OF SUSTAINABLE VALUE CREATION (2020), http://www3.weforum.org/docs/WEF_IBC_ESG_Metrics_Discussion_Paper.pdf [<https://perma.cc/B6YD-3LJR>] (proposing standards for corporate responsibility).

79. See Jill Fisch, *The Uncertain Stewardship Potential of Index Funds*, in GLOBAL SHAREHOLDER STEWARDSHIP: COMPLEXITIES, CHALLENGES AND POSSIBILITIES (Dionysia Katelouzou & Dan W. Puchniak eds., Cambridge Univ. Press, forthcoming), https://scholarship.law.upenn.edu/cgi/viewcontent.cgi?article=3141&context=faculty_scholarship [<https://perma.cc/T8TS-269H>] (“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

is inefficient, encourages greenwashing⁸⁰ and gamesmanship of the kind that has characterized corporate governance ratings,⁸¹ 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 society.⁸² Until this proliferation is alleviated by private

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., The Global Standards for Sustainability Reporting*, GRI, <https://www.globalreporting.org/standards> [<https://perma.cc/AW3Y-6YNW>]; *Download SASB Standards*, SUSTAINABILITY ACCT. STANDARDS BD., <https://www.sasb.org/standards/download> [<https://perma.cc/UMG6-Z4EX>]; WORLD ECON. F., *supra* note 78; TASK FORCE ON CLIMATE-RELATED FIN. DISCLOSURES, FINAL REPORT: RECOMMENDATIONS OF THE TASK FORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES 13–23 (2017), <https://www.fsb-tcfd.org/wp-content/uploads/2017/06/FINAL-2017-TCFD-Report-11052018.pdf> [<https://perma.cc/K6BQ-HMJH>]. 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 The Application of Environmental, Social, and Governance Principles in Investing and the Role of Asset Managers, Proxy Advisors, and Other Intermediaries Before the S. Comm. on Banking, Hous. & Urb. Affs.*, 116th Cong. 40 (2019) (statement of John Streur, President and CEO, Calvert Research and Management) (“85 percent 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* Sara Bernow, Jonathan Godsall, Bryce Klemptner & Charlotte Merten, *More than Values: The Value-Based Sustainability Reporting that Investors Want*, MCKINSEY & CO. (Aug. 7, 2019), <https://www.mckinsey.com/business-functions/sustainability/our-insights/more-than-values-the-value-based-sustainability-reporting-that-investors-want> [<https://perma.cc/68SR-SJgV>] (observing that 85 percent of “investors . . . agree or strongly agree that more standardization of [ESG] reporting” is required).

80. Greenwashing has been described as “the practice of making unwarranted or overblown claims of sustainability or environmental friendliness in an attempt to gain market share.” Richard Dahl, *Green Washing: Do You Know What You’re Buying?*, 118 ENV’T HEALTH PERSPS. A246, A247 (2010).

81. For criticism of corporate governance ratings, see Sanjai Bhagat, Brian Bolton & Roberta Romano, *The Promise and Peril of Corporate Governance Indices*, 108 COLUM. L. REV. 1803, 1826–27 (2008); Lucian A. Bebchuk & Assaf Hamdani, *The Elusive Quest for Global Governance Standards*, 157 U. PA. L. REV. 1263, 1268–69 (2009). *See generally* Robert Daines, Ian D. Gow & David Larcker, *Rating the Ratings: How Good are Commercial Governance Ratings?*, 98 J. FIN. ECON. 439 (2010) (finding that commercial governance ratings do not provide useful information for shareholders).

82. 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 ACCT. STANDARDS BD., THE STATE OF DISCLOSURE 21 (2017), https://www.sasb.org/wp-content/uploads/2019/08/StateofDisclosure-Report-web11271.pdf?__hstc=105637852.135a89045bd6ea85f68591478e99ebog.1553809423920.1570492048390.1570494269935.17&__hssc=105637852.1.1570494269935 [<https://perma.cc/4TPC-SAAF>]. 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., LYNN FORESTER DE ROTHSCHILD & E.L. ROTHSCHILD, THE EMBANKMENT PROJECT FOR INCLUSIVE CAPITALISM (“EPIC”): A BETTER WAY TO VALUE THE AMERICAN WORKER* (2019), <https://www.law.nyu.edu/sites/default/files/Forester%20de%20Rothschild%20Lynn%20-%20The%20Embankment%20Project%20for%20Inclusive%20>

action or legislation,⁸³ the only rational way to proceed is for the company's management and board to exercise judgment and to carefully select the EESG 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 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.⁸⁴ If society is serious about EESG, then corporations must be

Capitalism.pdf [<https://perma.cc/PQ9T-6K5D>]. And under the leadership of Chairman Clayton, the SEC has pressed for more informative disclosure about the worth of, and investments in, human capital, as well as in areas relevant to how corporations treat their employees. See Press Release, SEC, SEC Proposes to Modernize Disclosures of Business, Legal Proceedings, and Risk Factors Under Regulation S-K (Aug. 8, 2019), <https://www.sec.gov/news/press-release/2019-148> [<https://perma.cc/2FQX-UBM4>] (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, [sic] 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 from Cynthia A. Williams, Osler Chair in Bus. Law, Osgoode Hall L. Sch., York Univ. & Jill E. Fisch, Saul A. Fox Distinguished Professor of Bus. L., Univ. of Pa. L. Sch., Co-Dir. of Penn Law's Inst. for L. & Econ., to Brent J. Fields, Sec'y, SEC (Oct. 1, 2018), <https://www.sec.gov/rules/petitions/2018/petn4-730.pdf> [<https://perma.cc/8CGL-UPLX>]. 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.

83. 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 TASK FORCE ON CLIMATE-RELATED FIN. DISCLOSURES, *supra* note 79. 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.

84. See *supra* note 48 and accompanying text; see also Mark Carney, Governor, Bank of Eng. and Chairman, Fin. Stability Bd., Breaking the Tragedy of the Horizon—Climate Change and Financial Stability (Sept. 29, 2015), <https://www.bis.org/review/r151009a.pdf> [<https://perma>

expected to adhere to some level of consistency in reporting so that they can be held accountable using common measurements. 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, the allocation of responsibility among the company's management team, and, correspondingly, the organization of the board 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 be clear, 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 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.⁸⁵

But for present purposes, we are referring to the more mundane idea that the world is complex and that diverse expertise is essential for 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

.cc/RB8B-L45V] (observing that internationally consistent regulatory standards are important to producing successful EESG disclosure).

85. See, e.g., David A. Carter, Betty J. Simkins & W. Gary Simpson, *Corporate Governance, Board Diversity, and Firm Value*, 38 FIN. REV. 33, 51 (2003) (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. REV. 409, 410 (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, Mary-Hunter ("Mac") McDonnell, Sakshi Ghai & Jared Scruggs, *When and Why Diversity Improves Your Board's Performance*, HARV. BUS. REV. (Mar. 27, 2019), <https://hbr.org/2019/03/when-and-why-diversity-improves-your-boards-performance> [<https://perma.cc/BU8W-ZAGV>] (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, 1546 (2015) (finding mixed evidence for the claim that women on boards increases a company's financial performance).

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 other's bailiwick through the experience of working in a company in the same industry, but no one would think that they could completely change jobs without great risk to the company and society.

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 EESG. 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.⁸⁶ This is problematic for two interactive reasons: (1) audit committees' core responsibilities in 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 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.⁸⁷

86. See NAT'L ASS'N OF CORP. DIRS., 2019–2020 NACD PUBLIC COMPANY GOVERNANCE SURVEY 18 (2020), <https://corpgov.law.harvard.edu/wp-content/uploads/2020/01/2019-2020-Public-Company-Survey.pdf> [<https://perma.cc/7QFF-4B36>] (reporting that 31 percent of boards locate enterprise risk management in the audit committee, while only 16 percent of boards locate risk management in a risk committee, although 51 percent of boards report that the full board is responsible for risk management); *id.* at 25 (noting that 63 percent of boards locate compliance responsibilities in the audit committee).

87. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 407, 116 Stat. 745, 790 (codified as 15 U.S.C. § 7265 (2018)) (requiring the SEC to issue 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. NYSE LISTED COMPANY MANUAL § 303A.07(a) cmt. (2021) ("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 STOCK MARKET RULEBOOK § 5605(c)(2)(A) (2021) ("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

Directors whose background is not in finance, but who have other relevant talents, may rightly feel inhibited in declaring themselves to have the depth of finance acumen to qualify for those committees. 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.⁸⁸ This escalating complexity has further fueled the desire for financially minded audit committee members. These enhanced requirements also added obligations to what was already the most burdened board committee.⁸⁹

The resulting time pressures have another important effect. The core duties of an audit committee 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 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 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 necessary to address the company's other non-financial risks and compliance issues is identical to that sought in audit committee members. Much more likely, corporations 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 not in accounting or finance. Correspondingly, the fact that someone was a top KPMG accountant or a CFO at a Fortune 100 company may make them an ideal audit committee member. But that

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.”).

88. See *supra* notes 40–42.

89. See AUDIT COMM. INST., KPMG, AUDIT COMMITTEE WORKLOAD: KEEPING AN EYE ON THE BALL 4 (2014), <https://home.kpmg/content/dam/kpmg/pdf/2015/10/audit-committee-workload.pdf> [<https://perma.cc/VgVB-Z9P3>] (surveying 1,500 audit committee members, 75 percent of whom stated 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.”).

experience may give them 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 general counsel herself might ideally wish to discuss.

From a business perspective, the resulting allocation of talent and time is suboptimal and inefficient. By putting a critical function in a committee that cannot perform it effectively, the board risks missing issues, limits communication between the directors and a more diverse set of company officers, and is also likely to be spreading its work 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 by giving its accountants responsibility for compliance with non-financial regulatory requirements, such as environmental rules. 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,⁹⁰ this is no small benefit in itself, as it opens more windows into the company for the board and creates a better insight into corporate culture.

90. See SPENCER STUART, 2019 U.S. SPENCER STUART BOARD INDEX 15 (2019), https://www.spencerstuart.com/-/media/2019/ssbi-2019/us_board_index_2019.pdf [<https://perma.cc/3JR8-PFN7>] (“85% of all S&P 500 board directors are independent . . . Boards average 9.1 independent directors and 1.6 affiliated directors.”).

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 have a specialized expertise that 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.⁹¹ Rather than integrate EESG into the 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 responsibility should 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 above, 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,⁹² this will necessitate creating at least one committee

91. NAT'L ASS'N OF CORP. DIRS., *supra* note 86, at 27 (reporting that 30 percent of boards locate ESG responsibilities in the nominating and governance committee, compared to just 5 percent that locate those responsibilities in the audit committee—although 55 percent of boards still locate ESG responsibilities at the full board level).

92. 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 Glob. Holdings Inc., Proxy Statement (Schedule 14A) 33 (Dec. 9, 2019).

that has risk management, compliance, and EESG functions addressing some critical non-financial areas of concern, such as environment for an energy company or product safety for a pharmaceutical or food company.⁹³ This allocation could also come with responsibility for attendant areas of concern, such as a concern for cybersecurity and consumer privacy for companies that collect sensitive information from their customers. Establishing such a committee would help directors to satisfy both their legal obligations under *Caremark*⁹⁴ and the nonlegal need to address EESG concerns.⁹⁵

But in general, it is 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 revisited 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

Likewise, Citigroup has established an Ethics, Conduct and Culture Committee. Citigroup Inc., Proxy Statement (Schedule 14A) 41 (Mar. 11, 2020).

93. One size does not always fit all in corporate governance, though we 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). See generally 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.

94. 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).

95. 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, S. Trevis Certo, R. Duane Ireland & Christopher R. Reutzel, *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?* 3 (Univ. of Mia., Working Paper, 2020), https://www.bus.miami.edu/_assets/pdfs/thought-leadership/academic-departments/accounting/seminars/raghunandan-rajgopal.pdf [<https://perma.cc/7T3L-UP2J>] (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.

emerged in American corporate governance, compensation committees have focused obsessively on the compensation 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, on 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 on 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 are similar to those of the company adopts for its own workforce. But, there is an increased demand for corporations to give greater consideration to these areas, as exemplified by the United Kingdom'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.⁹⁶ And bills in Congress show a growing interest in having worker representatives on boards,⁹⁷ 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 company's workforce overall, on the one hand, and its stockholders and top management, on the other.⁹⁸

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 one

96. FIN. REPORTING COUNCIL, *supra* note 58.

97. See *supra* note 17 and accompanying text.

98. In a related paper, two of us explain how this might work. Leo E. Strine, Jr. & 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*, 76 BUS. LAW. 31 (2021). Other learned commentators find this avenue promising. See generally Amelia Miazad, *Sex, Power, and Corporate Governance*, 54 U.C. DAVIS L. REV. 1913 (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. L. SCH. F. ON CORP. GOVERNANCE (May 1, 2019), <https://corpgov.law.harvard.edu/2019/05/01/the-compensation-committee-agenda-for-2019> [<https://perma.cc/AUR6-KSN9>] ("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.").

should recognize that for the entire board to do its collective job well, there is an advantage to specialization. Specialization allows boards to use their and management's diverse talents and limited time effectively to make sure that they identify all key issues. The result is a board that is 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 approval process could involve presentations by other committees about key areas of concern. And likewise, if audit is the approving committee, the board 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) 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.⁹⁹ 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.

V. 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 better inform business decisions; use the time of the board, management, and the overall workforce more efficiently; and better 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

99. Cf. Donald C. Langevoort, *Cultures of Compliance*, 54 AM. CRIM. L. REV. 933, 935 (2017) (exploring the role of culture in ensuring good compliance).

where the company has a material 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.