Walking back from the 'Friedman Doctrine'?

Re-examining the board's obligation beyond profit to shareholders.

BY DOUG RAYMOND

The establishment of the first corporations, particularly the Dutch East India Company in 1602, introduced a remarkable innovation — the ability to shield the owners from the firm's liabilities, a protection that was not available to partnerships or sole proprietorships. This limitation on general liability facilitated the expanded capital formation that supported risky ventures such as overseas trading expeditions and helped fuel the industrial revolution. Because the corporation's creditors were not able to seek recovery from the owners, early corporate charters required the approval of the government, and usually were granted only to enterprises that provided a significant public benefit, in addition to the economic return to the owners.

In 1970, more than 300 years after the Dutch East India Company's formation, Milton Friedman, in an extremely influential article in *The New York Times Magazine*, articulated the alternative view, that corporations — and their boards — should not pursue any social purposes other than to maximize the return to their owners. The pendulum has largely swung Friedman's way, with academics and investors asserting that while corporate boards may consider the interests of other constituencies, the purpose of the corporation is to maximize returns to its shareholders. The corporation law of many states, including Delaware, has effectively ratified the "Friedman doctrine," particularly in the context of a change in control of the corporation, when the board's obligation under the *Revlon* caselaw is to obtain the highest value reasonably available to the shareholders.

Although modern corporate governance principles no longer require that corporations have a public or social purpose in order to obtain limited liability for the owners, legislation was introduced in Congress (the Accountable Capitalism Act) in 2018 that would have required all larger businesses (more than $1 billion in annual revenue) to do just that. More recently, a group of Democratic senators established a working group to develop other legislative proposals and conduct oversight aimed at fundamentally reforming corporate governance. And

regardless of these legislative measures, one could argue that, especially when a business is being sold, the board should balance the economics to the owners with the interests of other constituencies, particularly if the sale may result in plant closings, layoffs, debt restructurings, etc. The corporation law in many states, principally Pennsylvania, has adopted that approach. It provides not only that the directors may consider other constituencies in addition to the shareholders — such as employees, customers, local communities, suppliers and the environment — but also that even in a change in control, the board does not have to give primacy to the interests of the shareholders.

In this pandemic year of 2020, debate over the role of the corporation in society has reignited, particularly whether boards should focus only on economic returns. In August 2019, Business Roundtable (BRT) had released a statement from 181 CEOs of some of the largest companies in the United States, who pledged to "lead their companies for the benefit of all stakeholders" (employees, customers, suppliers, creditors and communities in which they operate, not just stockholders) and promote economic opportunity for these other stakeholders. This shift to "stakeholder capitalism" marked a significant change from BRT's prior position that gave priority to increasing stockholder value. However, BRT and the signatories of this pledge have since come under sharp criticism for failing to live up to these words, especially when so much of the country has been severely impacted by the effects of the pandemic, as well as the national debates around police violence, racial injustice and the 2020 national election.

As directors reflect on how their boards navigated the pandemic and other societal issues, they should take up this broader consideration and contemplate what role in society their companies had in the past and should play in the future. Some boards may also consider the recent corporate structure of a benefit corporation, which has been adopted in many jurisdictions, most notably in Delaware. As a benefit corporation, a company can adopt a public benefit purpose in addition to economic return and empower its boards to consider not only the interests of shareholders, but also that public benefit purpose and the interests of other stakeholders in making decisions.

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While the benefit corporation model is relatively new, there are reportedly more than 10,000 benefit corporations nationwide, and several recent IPOs have been of benefit corporations. Moreover, in the next proxy season, some groups are pushing to present proposals to the boards of many public corporations to consider converting to a public benefit corporation to "ensure that it can fully account for its effect on society and the environment." At least one large reporting company has recently called a special meeting of shareholders to consider such a conversion.

The events of 2020 have served as a litmus test of the 2019 BRT pledge and revealed that its promise of stakeholder capitalism is far from being realized. As the debate regarding the role of corporations in society continues, and if legislative and other support for stakeholder capitalism increases, thoughtful boards will have prepared how they will respond to the issues being raised by these trends. ■

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