# The Duties They Are A' Changing

## The role of board members is being reassessed.

**BY DOUG RAYMOND**

The last few years have brought boards of directors to the threshold of dramatic change for the first time in decades, and boards need to consider how they will respond to the new environment. The rules governing corporate boards did not change much for most of the last 35 years, but potentially significant changes are now on the horizon.

Directors have fiduciary duties, meaning that they must act in the best interest of the beneficiaries of that obligation. In the words of associate Supreme Court Justice Benjamin N. Cardozo, one of the great jurists of the early 20th century, the obligation of a fiduciary is "something stricter than the morals of the marketplace. Not honesty alone, but the punctilio of an honor most sensitive, is then the standard of behavior."

For directors, this obligation is divided into a duty of loyalty and a duty of care. The duty of loyalty requires that the director be singularly focused on the interests of the corporation — not on the director's own personal agenda — while the duty of care mandates that the director pay careful attention to their work and be actively engaged in decisions that affect the corporation. The implications of these fiduciary duties have been explicated and refined over thousands of lawsuits and reams of commentary and articles in learned journals, particularly in addressing situations that are fundamental to the corporation. Examples of such situations include a change in control or insolvency, or substantial conflicts of interest, such as self-dealing transactions or where a director is aligned with a third party that is seeking to effect a fundamental transaction.

Until recently, less attention has been paid to the required object of the directors' attention. The corporation law of many states, including Pennsylvania, provides that these fiduciary duties are to be exercised to benefit the corporation, but this is not a particularly enlightening standard. A corporation is an abstract and intangible creation of state law and cannot itself be hurt or helped. And it is overly simplistic to presume that increasing revenues or profits is always in the best interests of the corporation. For example, consider a project being reviewed by the board that will increase earnings substantially, but will also require the corporation to take on a significant amount of new debt, cause a 10% reduction in employee headcount and potentially create environmental problems in the community. Under these circumstances, it is not obvious that seeking the increased profits would be in the best interest of the corporation.

In some jurisdictions, the law explains that in deciding what is in the corporation's best interest, the board has broad discretion and can look to whether and how various constituencies are affected by a proposed action. These stakeholders include shareholders, employees, customers, the communities in which the company operates and creditors, as well as other considerations that the directors believe are relevant to the decision.

In other jurisdictions, including Delaware, the law is reasonably clear that the board's decisions must be viewed through the single lens of how they benefit the stockholders, and while the board may consider the impact of a decision on other constituencies, the interests of the stockholders must be paramount. And, even in those jurisdictions where boards can treat the interests of other constituencies as equal in importance to those of the stockholders, many boards of directors will nonetheless choose to give primary consideration to the interests of the owners.

These formulations of the board's fiduciary duties have recently come under significant challenge, which may evolve into a new vision of the role of the directors. For example, many more companies have become publicly traded as benefit corporations, including the most successful IPO of 2020. Over the last year, at least 16 other public companies received shareholder proposals requesting that they convert to benefit corporations. A benefit corporation is a fairly new type of corporate legal structure that is seen as playing a broader societal role than just serving its traditional constituencies. Thus, when making a decision, the board must also consider the impact on society and the public, even if not directly related to the monetary value of the corporation.

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In addition, the current regulatory, institutional investor and societal focus on issues of ESG has made it all but certain that, at least for public companies, the corporation's record on these issues, particularly on environmental and sustainability issues, will become increasingly transparent. This will be correspondently important to investors, regulators and the stock exchanges, regardless of the board's own view of the significance of these concerns or their relevance to the constituencies on which the board had historically focused.

Another change that is rapidly impacting corporations is the growing importance of diversity in the boardroom, which is also at the top of the agendas of many regulatory bodies and legislatures, and a key focus for institutional investors, consumers and other groups. These groups are seeking much more influence for diverse directors and are not going to be satisfied if boards of predominantly older white men rely on "diversity of thought" in response to requests for diversity of color, background, etc.

Many boards will face challenges in how they will react to these changes, particularly in those companies where directors tend to be older and less diverse. The winds of change are starting to blow through the boardroom and may upend what has been a singular attention to shareholder returns in favor of a broader and more societally based focus. Thoughtful boards will want to consider how to react to these trends. ■

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