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# ESG: From Shareholderism to Stakeholderism?

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## ABSTRACT

*The debate of corporate purpose has remained unanswered for almost a century and after more than three decades of static shareholder primacy we are beginning to see a turning point. The long-standing historical debate has recently re-emerged due to various propositions and events. This highly demanded answer is specifically concerned on identifying for whom are companies managed for and consequently, what is the role of modern-day corporations in respect to society. Initially, in the 1930s it was believed that this purpose was supposed to be semi-public. The first turning point happened in 1970, Milton Friedman, Nobel prize winning economist, published an essay on the New York Times which strictly defended capitalism. His main point was that shareholders' value had to be maximized and their interest had to be a priority. For approximately 35 years this ideal was widely accepted and because of that it got implemented by jurisdictions and corporations themselves. Recently however, the debate has gotten back in a very strong matter as the concept of stakeholderism has developed into variety of concepts following the acronym ESG for Environmental, Social and Governance. The rationale for the former is mainly brought by the fact that there is the recurring belief that by stakeholders, it is meant everything that currently surrounding corporations. Consequently, there is now a great amount of social pressure regarding the equal balance of interest between the stockholders and the stakeholders and ESG. Various tentative proposals were published by powerful entities ranging from business leaders, politicians as well as Government entities. We will discuss what is influenced by the answer and what are the main points from both counterparties. All of which has the main objective of formulating an inference regarding a possible future's answer and whether we have a chance to see it in the short-term.*

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## INTRODUCTION

Corporations run large part of economies all over the world. Naturally, their strategies and objectives differ depending on what their original purpose is and what sector they're in. Nevertheless, there is a common goal that companies have and had in the past. The question regarding corporate purpose is one of the oldest corporate law issues and a detailed, in-depth answer has yet to be discovered. Until recently, maximizing shareholder value has been prevalent and evident. The public and the market, however, has been exerting pressure for some time now and powerful entities are taking steps forward to move shareholder primacy out of the spotlight to include stakeholderism. Historically, corporations had started with a completely public purpose. With the passing of time however, the demand of incorporations increased exponentially, originating the idea of modern corporations. We attribute two main theories that give a sense to what the general purpose of corporations should be: stakeholder theory and shareholder primacy. In the 1930s these two concepts were firstly introduced publicly by two leading figures: Adolph A. Berle and Merrick Dodd. The stakeholder theory was strongly taken on by Professor Dodd, having as one of his most powerful points that since corporations were essential for the social economy and welfare, the interests of the stakeholders and the stockholders must've been on the same level. In response to those claims, Adolph A. Berle takes the completely different approach with another concept, denoted as shareholder primacy. Firms were entirely financed by stockholders, hence, managers had to use those resources in their complete interest. After various cases in which courts had sided with Dodd's theory, Berle took his side and said that he was correct, emphasizing however, that it was "at least for the time being"1. Back then, a distinction had to be made, the definition of what corporate purpose is would've had an immense influence on the structure of the economy and the direction it would take. Stakeholderism would've inevitably brought the United States towards a completely dominant ideal of socialism. In 1970, Milton Friedman published an essay for The New York Times titled *A Friedman Doctrine: The Social Responsibility of Business is to Increase Its Profits* which has been looked at as a great turning point for the matter, dictating how it should be for almost half a decade. Critiquing the critics however, it has been argued that Milton Friedman was indeed one of the leading figures of the matter but not, the only individual accountable for the matter. In his essay, the economist affirmed Berle's initial point but more powerfully defending capitalism

as a whole. This debate regarding corporate purpose has re-ignited and is being discussed by Economists, Professors and Politicians. Different remarkable events can be attributed to this: The *Accountable Capitalism Act* proposed by Elizabeth Warren; the letter issued by Larry Fink; The Business Roundtable statement in 2019. Following the analysis of these matters, we scrutinize how the debate has recently developed, and more specifically, how the concept of stakeholderism has grown out to a concept much stronger than the one first introduced by Professor Dodd. Before however, we shall decompose the debate into four aspects (referred to as faces) and discuss how an arbitrary, in-detail answer would impact those pillars. The four faces we have attributed to the debate are: legal, managerial, financial and political. The legal side never really needed an in-detail answer. Nevertheless, there needs to be an understanding of whose interests the corporation is driven by in terms of management. This has a great impact on different sections of American corporate law like for example fiduciary duties. All these questions are relative to the management of the firm which brings me to the next point. The management debate takes into consideration all aspects from the relationship level between shareholders and the board of directors. We must find an harmonic relationship in addition to a clear division of power to maintain a peaceful and optimal firm. Doubts also arise regarding shareholder pressure; some critics find it oppressive and subject to opportunistic behavior while others believe it to be beneficial and fundamental for short-term focus and productivity. Martin Lipton has proposed a new framework regarding this internal issue which is of great importance for our interests. The finance debate on the other hand, is concerned about the measurement of a corporation's performance, which until now has been the unbiased and volatile stock price. In addition, the idea of the maximization of shareholder value is present in all finance textbooks, as well as choosing valuable investments, taking time in consideration as a negative factor. If the concept of shareholder primacy isn't dominant anymore, but on the contrary, the investment in stakeholders with a more long-term approach is, shall these theories change? Lastly, the political debate which on some sense is tied to the latter speaks upon the concept of stockholder primacy and its impact on the United States' economy in the long run and labor education. We will analyze the criticism that Senator Elizabeth Warren's Accountable Capitalism Act proposal has gotten and use it to go further down the path of assuming where the debate will take us. In addition to the former, the Senator as well as other scholars have also confronted the Business Roundtable signing CEOs' which have not been acting in correspondence to their 2019 statement.

In the last section we illustrate how stakeholderism has commonly commenced to be related to the concept of Environmental, Social, Governance (often referred to as ESG). This

term was first coined a year later the conference of 'Who Cares Wins: Connecting Financial Markets to a Changing World'. Initially, this acronym was utilized exclusively in financial discussions regarding investments. As sustainable investments have proved to be less risky with the chance of even providing greater returns with respect to a normal security, this term has gained more attention and meaning. Investors demand for the information of ESG factors has kept on building up to a point where information regarding this was beginning to be disclosed everywhere and often, used for marketing purposes. Reliability was starting to get questioned as ESG mutual funds extraordinarily grew and this is where Gary Gensler, chair of the Security Exchange Commission started to show interest in introducing a disclosure regulation framework, to be added onto the existing one, entirely focused on these factors. To be more specific, on climate and its relationship with the corporation. Following the analysis of the proposed framework, we will see how the Commissioner of the Security Exchange Commission Hester M. Pierce has contradicted it in her message titled: *We are not the securities and environment commission – at least not yet*. To conclude, following the deep examination of the debate, we point out the modern role of sustainability as well as the challenges it implies for corporations. All to then, attempt to make an argument regarding the direction of the debate but especially, try to estimate the proximity of a final answer.

## I. Analysis of Corporate Purpose

### *A. The Origins*

In the 19th century the first corporations were developed in the United States. At this point the common purpose was working partially if not mostly for the public, being categorized as a quasi-public service[1]. Following the second industrial revolution and especially the American civil war there has been an emergence of more modern-type corporations with a strictly profit-making objective, for example oil or banking companies[2]. All of these were run with the

[1] Stephen Bainbridge, *Corporate Purpose in United States of America Law and Practice*, Lecture Notes, Economics & Business, Luiss Guido Carli, *delivered* April 16th, 2021.

[2] *See* The Investopedia Team, *What is the history of corporations in America?*, Investopedia (May 6th, 2021), available at https://www.investopedia.com/ask/answers/041515/what-history-corporations-america.asp#:~:text=The%20first%20American%20corporations%20were,development%20like%20the%20United%20States.

intention of making a profit for their shareholders and it was widely accepted, at least up until the stock market crash of 1929 which caused the Great Depression[3]. This tragic historical event raised questions among the public regarding the managerial aspect of corporations, to which
many scholars participated trying to find a solution[4]. The two leading figures were Adolf Augustus Berle Jr. and Professor Merrick Dodd. Professor Dodd published a now considered classic Harvard Law Review article in 1932 named: *For Whom Are the Corporate Managers Trustees?*[5] This was concentrated on the modern concept of the stakeholder theory. He particularly stated that corporations were not simply profit-making vehicles but had become essential for the social economy and benefit, that is also a reason for which the government allowed incorporations in the first place[6]. This was leading all up to the grand point professor Dodd wanted to make: shareholders should not be in the focal point of a corporation, rather they should have a co-equal relationship with the stakeholders and law should adapt to it[7]. This is now a very relevant modern concept, nowadays it is very common for new generations to
prefer a job in a socially responsible company. Adolph Berle on the other hand, is considered to be one of the most influential authors of American corporate law. In 1932 he published *The Modern Corporation and Private Property* which is arguably the most important book that has ever been written on corporate governance and is indeed one of the most cited works in management studies[8]. The latter has indeed been described by Stephen Bainbridge as a landmark[9], as a matter of fact, anything prior to this publication is almost never looked at by scholars. Berle responded to Professor Dodd stating that the managers have in their hands the investments made by the shareholders, and the power that is given to them by the law should be used in their interest. His standpoint was clear, corporations were moving towards a

[3] *See* David McCord Wright, *The Modern Corporation: Twenty Years after,* University of Chicago Law Review *(1952).*

[4] *Supra* note 1.

[5] *See* E. Merrick Dodd, Jr., *For Whom Are Corporate Managers Trustees?*, 45 Harv. L. Rev. 1145 (1932), available at **Errore. Riferimento a collegamento ipertestuale non valido.**

[6] *See* Holly J. Gregory, Sidley Austin LLP*, Everything Old is New Again—Reconsidering the Social Purpose of the Corporation*, Harvard Law School Forum on Corporate Governance (Mar. 12th, 2019), available at https://corpgov.law.harvard.edu/2019/03/12/everything-old-is-new-again-reconsidering-the-social-purpose-of-the-corporation/

[7] Charles M. Elson and Nicholas J. Goossen, *See E. Merrick Dodd & the Rise and Fall of Corporate Stakeholder Theory* SSRN (May 15, 2017), available at *https://poseidon01.ssrn.com/delivery.php?ID=376121095090078099103092030098005123096024026051006017127103010071122095006127027028042012019003037044061069074006088118122067013080022030086117072019103106028051002087021090102124023027123094086000101088008104123024029068088083030091088118123097&EXT=pdf&INDEX=TRUE*

[8] *See* Andrew Smith, Kevin D. Tennent & Jason Russell*, Berle and Means's The Modern Corporation and Private Property: The Military Roots of a Stakeholder Model of Corporate Governance,* Seattle University Law Review *(Aug. 2018), https://digitalcommons.law.seattleu.edu/cgi/viewcontent.cgi?article=2584&context=sulr*

[9] *Supra* note 1.

direction to which a distinction had to be made. On one side of the spectrum, we have socialism and corporations with a quasi-public function while on the other we have a capitalistic private property orientation. He described Professor Dodd's 'proposal' as an inevitable jump to socialism10. Twenty years later, in 1953, a very important decision was taken by the court of New Jersey in the *A.P. Smith Mfg. Co v. Barlow11* case. In this peculiar situation we have Smith company that made a great donation to Princeton University which was then used by a stockholder as rationale to initiate a lawsuit regarding the legality of this transaction. The court stated that companies were permitted this certain type of donations since they had a major influence on social benefit12. This statement has a strict resemblance with Professor Dodd's point of view on the matter, indeed he then proceeded to declare that his beliefs were not about socialism but capitalism. His main argument was: "The only way to defend capitalism is through leadership which accepts social responsibility and meets the sound needs of the great majority of our people"13. Adolph Berle then declared in the *20th Century Capitalist Revolution* that: "The argument has been settled (at least for the time being) squarely in favour of Professor Dodd's contention"14. Nevertheless, we shall say that the aspects that both figures believed at the time have been spoken of and considered ever since, especially now that the debate on corporate purpose has re-emerged. In the late 20th century, Milton Friedman, a Nobel-prize winning economist published an essay for The New York Times titled *A Friedman Doctrine: The Social Responsibility of Business is to Increase Its Profits15*. In the latter he expressed what seems to have been Berle's initial point but more powerfully: "there is one and only one social responsibility of business—to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception fraud"16. Friedman has always defended the concept of capitalism and 'freedom', all of his points were particularly against what Professor Dodd introduced. His main points regarding corporate social responsibility were that shareholders are not able to decide how their money will be spent, so since it's the

[10] *See Who was right Dodd or Berle?* Prithvijoy Das, , SSRN (Apr. 18, 2019), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3374292&download=yes.

[11] *SeeA. P. Smith Mfg. Co. v. Barlow - 13 N.J. 145, 98 A.2d 581* (1953).

[12] *See A. P. Smith Mfg. Co. v. Barlow - 13 N.J. 145, 98 A.2d 581available at* , (1953), https://www.lexisnexis.com/community/casebrief/p/casebrief-a-p-smith-mfg-co-v-barlow.

[13] *Supra*, note 5.

[14] *See The 20th Century Capitalist Revolution* Adolph A. Berle, Jr., , 169 (1954), https://www.jstor.org/stable/1120768

[15] *See , A Friedman doctrine- The Social Responsibility Of Business Is to Increase Its Profit,* Milton Friedman -New York Times(Sept. 13, 1970), available at https://www.nytimes.com/1970/09/13/archives/a-friedman-doctrine-the-social-

[16] *Id.*

managers that have complete control over it they should focus on activities strictly related to company profit unlike charity17. Secondly, he states that the only reason for hiring a corporate executive as a shareholder is that the individual acts in the interest of his principal. Then

concludes saying that: “This justification disappears when the corporate executive imposes taxes and spends the proceeds for "social" purposes. He becomes in effect a public employee, a civil servant, even though he remains in name an employee of a private enterprise”18. These last points arguably mean that corporate social responsibility automatically brings to socialism, which is something that has already been seen before with Berle in the 1930s. Milton Friedman’s arguments have remained the common assumption for corporate purpose for almost 35 years, up until the idea of social responsibility re-emerged in the beginning of the twenty- first century. However, has Milton Friedman completely eradicated what was the main manager mentality for corporate purpose? The noble prize winning economist has had his essay referred to as “the origin of the world’s dumbest idea”19 by critics. As well as what was contradicted by the business roundtable statement in 2019 which we are going to discuss further

into the paper20. But, contrary to the former statements, in addition to all of the similar matter, we aren’t able to assess the beginning of shareholder primacy from this event only. “Historical evidence does not tally with the hype”21. To be more specific, Brian R. Cheffins states that scholars that assess great, if not all, responsibility to Milton Friedman towards this shift to shareholderism are erroneously assuming implicit concepts about his essay and how it all developed out. On the top of it, it can be argued that this shift hasn’t began right after this so-called ‘turning point’ but after a dozen of years in the mid 1980s. As a matter of fact, Milton Friedman’s essay caused little to no change in managerial priorities in the imminent future after publication. To conclude, it is undeniable that the former has had a great influence on American’s corporate law22, however, it could be argued that critics are erroneously referring to it when it is illustrated as what completely caused the movement from stakeholderism and replaced it with shareholderism. In 2013, we see how legislation commenced to

[17] *See* Peter Prevos and Ian Watson, *Milton Friedman on Corporate Social Responsibility,* Lucid Manager (July 14th, 2019), available at *https://lucidmanager.org/management/milton-friedman-corporate-social-responsibility/*

[18] *Supra* note 15.

[19] *See* Steve Denning, *The Origin Of ‘The World’s Dumbest Idea’: Milton Friedman,* Forbes (June 26th, 2013), available at https://www.forbes.com/sites/stevedenning/2013/06/26/the-origin-of-the-worlds-dumbest-idea-milton-friedman/?sh=2f88480b870e.

[20] *See* Colin Mayer*, Ownership, Agency, and Trusteeship, ECGI Working Paper No. 488/2020, SSRN (2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3522269.*

[21] *See* Brian R. Cheffins*, Stop Blaming Milton Friedman!,* SSRN (March 11th, 2020), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3552950

[22] *See* Sean McAleer, *Friedman's Stockholder Theory of Corporate Moral Responsibility*, SpringerLink (Nov. 2003), https://link.springer.com/article/10.1023/B:TEBE.0000005711.70399.51.

show real sensibility towards other stakeholders when Delaware legislation gave birth to the first for-profit public benefit corporations that had the intention to produce a social benefit in a sustainable and responsible manner while still having as a recurring goal to produce profit and hence, shareholder value[23]. To conclude, one of the most influential and significant steps in corporate law history has been taken by the business roundtable. This association is well known for their input and influence on American corporations, indeed, one of their most remarkable occupations was to periodically publish statements regarding corporate purpose[24]. In August 2019 they have contradicted all their past publications by acknowledging another side of the spectrum when indicating how firms should operate and towards which set of objectives, showing great relevance to stakeholders[25]. The latter will be described more in-depth as we get into the present debate that is taking place, as well as touching the matter of if these CEOs are actually 'walking the talk'[26] and Senator Elizabeth Warren's intervention on the matter[27].

## *B. Theoretical Principles*

Corporate Purpose, as previously anticipated can be divided into two main theories: stakeholder theory and shareholder primacy. Both of these try to dictate what a corporation's general role should be[28]. Shareholder primacy states that stockholders finance corporations' managers,

[23] *See* Michael R. Littenberg and Emily J. Oldshue, *Delaware Public Benefit Corporations—Recent Developments*, Harvard Law School Forum on Corporate Governance (Aug 31st, 2020), available at https://corpgov.law.harvard.edu/2020/08/31/delaware-public-benefit-corporations-recent-developments/#:~:text=Public%20benefit%20corporation%20legislation%20was,a%20responsible%20and%20sustainable%20manner.

[24] *See* Business Roundtable Editing Team, *About Us,* Business Roundtable (last visited May 4th, 2022), available at https://www.businessroundtable.org/about-us

[25] *See* Chirag Lala, Lenore Palladino, *Shareholders First: What Hasn't Changed since the Business Roundtable's 2019 Statement*, Roosevelt Institute (Aug. 19th, 2020), available at https://rooseveltinstitute.org/2020/08/19/shareholders-first-what-hasnt-changed-since-the-business-roundtables-2019-statement/

[26] *See* Stefanie Spear, *Shareholders to BlackRock: It's Time to Walk the Talk, Implement Business Roundtable's 'Purpose of a Corporation'*, As You Sow (Dec. 17th, 2019), available at https://www.asyousow.org/press-releases/blackrock-business-roundtable-statement-purpose.

[27] *See* Elizabeth Warren, Senator Warren to Business Roundtable: Your 2019 Commitment to 'Promote an Economy that Serves all Americans' Was an Empty Publicity Stunt (Sep 17th, 2020), available at https://www.warren.senate.gov/newsroom/press-releases/senator-warren-to-business-roundtable-your-2019-commitment-to-promote-an-economy-that-serves-all-americans-was-an-empty-publicity-stunt.

[28] *See* Jason Hung, *Shareholder Primacy Theory vs. Stakeholder Theory*, SSRN (Apr. 24th, 2020), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3564804.

which then are supposed to spend that money exclusively for their interest. The main argument has always been profit maximization, we've previously discussed Milton Friedman's view on the duty of a corporation being to maximize profits as long as it remained 'within the rules of the game'29. There are several points that defend this ideal. First, stockholders are the residual claimants in a corporation, increasing their value will consequently maximize the firm's as well. Secondly, stock price can be utilized as an unbiased measurement of the company's growth30. Following, the cumulative interest of greater dividends is usually homogeneous and largely unitary, as a matter of fact their gain is usually pro rata. The latter could be considered almost as a double-edged weapon, it is not that uncommon for shareholders to put a certain type of pressure onto directors for short-term focus and misallocation of resources31. Lastly, shareholders have some legal power over the corporation when it comes to electing directors or voting on certain structural issues, meaning that they can hold directors and officers accountable32. Some of these points in defence of stockholder theory have been

argued many times, for example there were some cases in which stakeholders were treated as residual claimants of the corporation33. The stakeholder theory, previously spoken of by Professor Dodd takes a completely different approach. From this point of view corporations are seen as persons, having ethical and moral obligations towards all stakeholders ranging from the employees to the clients and even competitors. As a matter of fact, this theory is usually used to justify a purpose in companies that are concerned and fervent about social welfare. Despite all of this, imposing this doctrine would not provide a strong enough corporate purpose, Elizabeth Pollman on this matter stated: "the so-called doctrine of corporate personhood does not provide guidance for determining the scope of corporate rights34". This

[29] *See* H. Jeff Smith, *The Shareholders vs. Stakeholders Debate*, MITSloan Management Review (Jul. 15th,2003), available at *https://sloanreview.mit.edu/article/the-shareholders-vs-stakeholders-debate/*.

[30] *See* Judy Samuelson, *The Impact of Shareholder Primacy: What it Means to put the Stock Price First*, Aspeninstitute (Mar. 16th, 2022), available at https://www.aspeninstitute.org/of-interest/the-impact-of-shareholder-primacy-what-it-means-to-put-the-stock-price-first-2/.

[31] *See* William Lazonick, *Profits Without Prosperity,* Harvard Business Review (Sep. 2014), available at *https://hbr.org/2014/09/profits-without-prosperity*.

[32] *See* Jill E. Fisch, *Should Corporations Have a Purpose?*, Penn Law Legal Scholarship Repository (Feb 2nd, 2021), available at https://scholarship.law.upenn.edu/cgi/viewcontent.cgi?article=3165&context=faculty_scholarship.

[33] *See* Sung Eun Kim, *Dynamic Corporate Residual Claimants: A Multicriteria Assessment,* Chapman Law Review, Vol. 25, No. 1, (May 31st, 2022), https://deliverypdf.ssrn.com/delivery.php ID=245087086113074021089091088072067103113043039055000059064099011000067016031028119064102049096037117024113115123115101005009006057081030030036080105006025093012018087017007075110001020110085104090079126031123110103086072083006025015023006085009013008020&EXT=pdf&INDEX=TRUE.

[34] Elizabeth Pollman, *A Corporate Right to Privacy*, 99 MINN. L. REV. 27, 51 (2014), https://www.minnesotalawreview.org/wp-content/uploads/2014/12/Pollman_MLR.pdf

is naturally caused by the fact that people have different opinions on what the constraints are on ethical behaviour, limiting the answer that this could give to the question of corporate purpose35. Dr. Manne offers a definition of what actions are considered socially responsible, made up of three main points: the business expenditure must offer a lower potential return than
other options, must be purely voluntary and shall be classified as a corporate expenditure rather
than a donation36.

### *C. Legal Arguments*

To comprehend the real purpose of a corporation we must also analyse it from a legal perspective. Naturally, the management strategy of a corporation varies with its function, nevertheless there is an ideal which is historically widely approved. In traditional jurisdictions like Delaware's, the purpose of a corporation is exactly as how Chancellor William Chandler described it: "to promote the value of the corporation for the benefit of its stockholders"37. Shareholder primacy until now has not been a legal duty but a legal obligation, scholars have even described it as a 'judge-made law'38. We shall highlight the fact that law can be enforceable by sanction or have compliance by other means. In other words, the latter could be described as laws which are unenforceable or enabling39. For example, corporate law is said to be enabling, since it gives the possibility to artificial entities to be characterized as a private person, with the powers to create legal and economical relationships with other corporate individuals. Over several decades, shareholder primacy has become far more than a social custom or habit. We might argue that it has become a rule that has a strong social pressure behind it even if it is not enforceable. Nowadays it is widely accepted as the basis of corporate purpose and governance and indeed it has been integrated in many principles and rules of corporate law40. In addition, we must point out that a sanction-type law cannot co-

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35 *Supra* note 22.

36 *See* AEI Press, *The Modern Corporation and Social Responsibility,* AEI (Jan. 1st, 1987), available at https://www.aei.org/research-products/book/the-modern-corporation-and-social-responsibility/

37 *See* William Chandler, *eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 34* (Del Ch. 2010), H20 (Sep 9th, 2010), *https://h2o.law.harvard.edu/cases/3472*.

38 *See* Robert J. Rhee, *A Legal Theory of Shareholder Primacy,* Harvard Law School Forum on Corporate Governance (Apr. 11, 2017), available at *https://corpgov.law.harvard.edu/2017/04/11/a-legal-theory-of-shareholder-primacy/*.

39 *See* Mark J. Loewenstein and Jay Geyer, *Shareholder primacy and the moral obligations of directors*, 110 Fordham Journal of Corporate & Financial Law (Sep. 9, 2020), available at *https://ir.lawnet.fordham.edu/cgi/viewcontent.cgi?article=1493&context=jcfl.*



40 Id.

exist between shareholder primacy and managerial authority, simply for the fact that it would be internally incoherent41. In a corporation there are agency costs and its inevitable, therefore management must be in a rule-sanction form. Shareholder primacy on the other hand is a background rule with no sanction. These two concepts are correlated, shareholder primacy consists in the managers acting for their interest while the managers need a financing for the corporation. I might argue then that a balance is fundamental, and an enforceable fiduciary duty
does that42. In various cases where courts could not avoid taking a decision regarding a conflict of interest between the stakeholders and the shareholders, the latter has always come
out on top. This contrast becomes more evident and relevant in takeovers of a corporation. In this regard, we shall speak upon one of the most influential and popular takeover cases, Revlon *v. MacAndrews & Forbes Holdings, inc. 43*. At the time, the Delaware Supreme Court did not hesitate to clearly state that the board facing the change of control was required to obtain the "*highest price for the benefit of the stockholders"*44. In the auction that took place to sell the company, there was a bidder that was ahead of all others because of a suspicious inadequate offer. Consequently, the board of directors was led to believe that the acquisition by this individual would have been catastrophic for the corporation. Being concerned about other stakeholders, the board of directors took on some defensive tactics. At the beginning they were arguably in the interest of the shareholders, however they then completely diverged after granting an asset lock-up to another entity. Finally, the Supreme Court claimed that the directors allowed considerations other than maximization of shareholder value to affect their judgement45. We might consider the fact that if in these occasions the board of directors completely ignores the interest of the other stakeholders, they might lose the incentive or devotion they have towards the firm46. Various examples like this only strengthened this point, managers and directors did not really have a choice but to incorporate it internally. It was inevitable that after consequent decades of this prevalence, we have a strong shareholder-oriented economy, and not only in America but also the rest of the world47.

41 *Supra* note 38.
42 *Supra* note 28.
43 *See Revlon v. MacAndrews & Forbes Holdings*, inc., 506 A.2d, 173 (Del. 1986).
44 *See Revlon, Inc. v. MacAndrews & Forbes Holdings,* JUSTIA US Law (last visited Feb. 9th,2022) *https://law.justia.com/cases/delaware/supreme-court/1986/506-a-2d-173-1.html .*
45 *See Revlon v. MacAndrews & Forbes Holdings, inc., 506 A.2d, 173,* (Del. 1986), https://www.lexisnexis.com/community/casebrief/p/casebrief-revlon-inc-v-macandrews-forbes-holdings-inc.
46 *Supra* note 28.
47 *See* Lynn A. Stout, *New Thinking on "Shareholder Primacy",* 5 Cornell University Law Library (2012), available at https://scholarship.law.cornell.edu/cgi/viewcontent.cgi?article=2688&context=facpub.

## II. The Debate

Now that we have analysed the historical, legal and theoretical aspects of corporate purpose we can understand moreover what the question is. The debate regarding this is currently being discussed upon all over the world. There have been a series of events which are the causes of the 'reignition' of this historical question. First, the Accountable Capitalism Act, a bill proposed by Elizabeth Warren in 2018. The Senator affirmed that until now, most of the corporations including the largest ones have dedicated 93% of their earnings to stockholders[48]. Consequently, this led to under-investment, giving opportunities to foreign competitors. All of this brings us to a political aspect of this debate that we are going to touch upon later. This bill consisted in restructuring completely corporations in America restricting sales of company shares and having mandatory federal charters for corporations that have more than a billion dollars in annual revenue. Elizabeth Warren has also suggested adopting the German controversial aspect of co-determination[49]. The latter has been criticised by Professor Stephen Bainbridge in different occasions making various points, all of them to get to the conclusion that it's overall less efficient than the Anglo-American tradition of excluding workers from board representation[50]. Secondly, in the same year, a letter was issued by the BlackRock CEO, Larry Fink. This requested that companies had and disclosed about their participation in stakeholder and social welfare, specifically stating that: "Society is demanding that companies, both public and private, serve a social purpose. To prosper over time, every company must not only deliver financial performance, but also show how it makes a positive contribution to society. Companies must benefit all of their stakeholders, including shareholders, employees, customers, and the communities in which they operate"[51].

Lastly, the Business Roundtable, an association described from the Wall Street Journal as *"one of the capital's most influential associations of business leaders"[52],* has issued a new statement which contradicted the previous twenty-three that had been published, all of them

[48] *See* Elizabeth Warren Press, *Accountable Capitalism Act*, Elizabeth Warren (May 7, 2021), available at https://www.warren.senate.gov/imo/media/doc/Accountable%20Capitalism%20Act%20One-Pager.pdf.

[49] Co-determination: cooperation between management and workers in decision-making, especially by the representation of workers on management boards.

[50] *See* Stephen Bainbridge, *Privately Ordered Participatory Management: An Organizational Failures Analysis*, 8 SSRN (May 8th, 2021), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=38600.

[51] *See* Larry Fink, *A Sense of Purpose,* Harvard Law School Forum on Corporate Governance (Jan 17th, 2021), available at *https://corpgov.law.harvard.edu/2018/01/17/a-sense-of-purpose/#comments*.

[52] *See* Elizabeth Williamson, *Business Group Taps Former GOP Governor,* Wall Street Journal (Dec. 22, 2010), available at https://www.wsj.com/articles/SB10001424052748703581204576033732819908912 .

endorsing shareholder primacy. This new statement outlines a modern long-term focused standard for corporate responsibility that is based on six fundamental principles: Delivering value to the customers, meeting if not exceeding expectations. Investing in employees, compensating them fairly and supervising them through training and education. Act ethically in respect to the firm's suppliers. Support the community and environment in which the firm is in. Finally generating long-term value for shareholders, committing to transparency and effective engagement with shareholders[53]. It has been argued by several members of the BRT that the profit incentive was leading to a single minded, short-term focus that in some cases pushed companies to ignore the interests of other stakeholders, and society at large[54]. On the other hand, this new model describes certain aspects which were already present in most modern corporations, however by specifying it the BRT induced some type of accountability to the CEOs. One of the members, has clarified in an interview with CNBC that these are not "*or statements*"[55], as a matter of fact these combined are fundamental for the longevity and success of a firm. To conclude, the question of corporate purpose influences and therefore could be seen from four different point of views: legal, managerial, financial and political[56]. All of these ramifications lead up to different questions and logically their answers might be different and not correlated with each other.

## *A. The Four Faces of the Debate*

### 1. Legal Side

[53] *See* Business Roundtable Editing Team, *Business Roundtable Redefines the Purpose of a Corporation to Promote 'An Economy That Serves All Americans',* Business Roundtable (Aug. 19th, 2019), available at https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans.

[54] *See* Andrew Winston, *Is the Business Roundtable Statement Just Empty Rhetoric?*, Harvard Business Review (Aug. 30th, 2019), available at https://hbr.org/2019/08/is-the-business-roundtable-statement-just-empty-rhetoric.

[55] *Interview by* CNBC with Rich Lesser, CEO of the Boston Consulting Group, *available at* https://www.cnbc.com/video/2019/08/26/business-roundtable-role-of-companies-shareholder-values-squawk-box.html

[56] *See* Edward Rock, *For Whom is the Corporation Managed in 2020?: The Debate over Corporate Purpose*, SSRN (Sep, 2020), available at https://poseidon01.ssrn.com/delivery.php?ID=018087083066115100094094096119099102052027021001058001027072082064094094086123079077099118053037011111023121103066022072066102122027038089015091121115116007025101006049011063124022085005125068075004098102007102110107070121011099003090120064012082004078&EXT=pdf&INDEX=TRUE

For jurisdictions and courts, the question about corporate purpose must be looked at from a different perspective to gain a substantial amount of importance. For whom is the corporation managed[57]? This is what law demands, the answer to the question of who should prevail when

there is a conflict of interest. There are various doubts that have arose with different points behind them. We will start by takeovers and acquisitions since it's an argument that we have already introduced previously. There is no other occasion in corporate law in which the conflict of interest between stockholders and stakeholders is this evident[58]. When a sale of a company is involved it's natural that most of the shareholders that are planning to exit won't think about the long-term opportunities of the corporations but instead will be concerned about the price-per-share they're going to fulfil when leaving. This completely goes against the board of directors' which will be concerned about the stockholders and generally, the firm's 'health'. There is no better example than the *Revlon* case[59] that we have discussed upon before, on one side we have the board of directors which is concerned about the stakeholders' interests and the corporation. On the other hand, we have the shareholders which are trying to obtain the highest possible offer for the corporation. So, the relevant question that comes to mind during takeovers is, who should the board of directors represent, and what actions are in their power? We shall also consider the fact that the board of directors must operate in some well-defined constraints according to concepts like the Business Judgment Rule. The case of *Unocal Corp. v. Mesa Petroleum*[60] assists us in comprehension to this matter. This case led the Delaware Supreme Court to establish the Unocal test, largely known as the enhanced scrutiny test, used to determine whether the Business Judgment Rule applies or not[61]. This stated that when a board of directors takes defensive action against a takeover threat it "must demonstrate that it had reasonable grounds for believing that a danger to corporate policy and effectiveness existed"[62], in addition, the remedy taken must be in scale with the danger. Secondly, there

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[57] *Id.*

[58] *See* Shrisha Juneja, *Conflicted Mergers Transactions: Consolidating the Standards of Review*, 143 Fordham Journal of Corporate & Financial Law (April, 2017), available at https://core.ac.uk/download/pdf/144231853.pdf.

[59] *Supra* note 43.

[60] *See* Unocal Corp. V. Mesa Petroleum Co., 493 A.2d, 946 (Del. 1985). In more detail, Mesa Eastern inc., the owners of 13% of Unocal corporation's stock started a tender offer which had the purpose of eliminating publicly held shares by an exchange of securities, Unocal in response commenced with a stock buy-back to prevent Mesa from taking control of the company, to do so it issued leverage and therefore debt. As a consequence, Mesa initiated a lawsuit claiming that Unocal's offer was beyond the power of the board and a breach of fiduciary duty.

[61] *See Unocal Corp. v. Mesa Petroleum Co. - 493 A.2d 946 (Del. 1985), available at https://www.lexisnexis.com/community/casebrief/p/casebrief-unocal-corp-v-mesa-petroleum-co-513322316*

[62] *See* Cornell Law School, *Enhanced Scrutiny Test, available at https://www.law.cornell.edu/wex/enhanced_scrutiny_test*.

is another situation that completely goes against shareholder's interest that has gained a lot of popularity lately, the legislation regarding wholly owned subsidiary parent companies[63]. Intuitively we might think that a wholly owned subsidiary firm would have coinciding interest with the stakeholders of the parent company, unfortunately this isn't the case[64]. It is not uncommon that the subsidiary's directors cannot act for their corporation's own interest but must do what the parent company demands. For example, it is not unusual that they buy or supply a certain type of good from the parent firm at an inconvenient price. There are little to no cases regarding the application of the Business Judgment Rule for actions that the board of directors took in a subsidiary company in the interest of the parent. The Supreme Court has clearly stated that: "in a parent and wholly-owned subsidiary context, directors of the subsidiary are obligated only to manage the affairs of the subsidiary in the best interest of the parent and its shareholders"[65]. More can be seen in the case in which Trenwick America, wholly owned subsidiary company was obliged to operate in the sole interest of Trenwick, it's only stockholder. "That is even so if the Trenwick America board took actions that made Trenwick America less valuable as an entity. If the Trenwick America board authorized the subsidiary to provide (as it appears to have done) guarantees to Trenwick's creditors that supported Trenwick's overall business, they would have been managing the subsidiary to benefit its parent..."[66]. This shows us that in these cases stakeholders of the subsidiary company

are not even considered by any means. Third, in 2010 the first acts regarding Public Benefit Corporations have passed in Maryland[67]. Public corporations are for-profit corporate entities which in addition to concentrating on shareholders, focus also on having a positive impact on social welfare[68]. This amendment of the jurisdiction quickly expanded onto other

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[63] *See* Lauren Mcmenemy, *Addressing Conflicts of Interest in Subsidiary Listings,* Diligent (Jan. 3d, 2020), available at https://www.diligent.com/insights/subsidiary-management/addressing-conflicts-interest-subsidiary-listings/.

[64] *See* Eric J. Gouvin, *Resolving the Subsidiary Director's Dilemma*, 289 UC Hastings Law (1996), available at *https://digitalcommons.law.wne.edu/cgi/viewcontent.cgi?article=1072&context=facschol*

[65] *See Anadarko Pet. Corp. v. Panhandle East. Corp.*, 521 A.2d 624 (Del. Ch. 1987).

[66] *See Trenwick America Lit. v. Ernst Young*, 906 A.2d 168, 201 (Del. Ch. 2006).

[67] *See* Gene Takagi, *Maryland's benefit corporation*, neo LAW GROUP (May 26th, 2010), available at https://nonprofitlawblog.com/marylands-benefit corporation/#:~:text=On%20April%2013%2C%202010%2C%20Maryland,responsible%20purposes%20in%20addition%20to

[68] *See* Wex Definitions Team, *public benefit corporation*, Law Cornell Legal Information Institute (Nov. 2020), available at https://www.law.cornell.edu/wex/public_benefit_corporation#:~:text=A%20public%20benefit%20corporation%20is,a%20responsible%20and%20sustainable%20manner.

states like New Jersey, Vermont and Virginia69. The more jurisdictions adopted this aspect the more activist pressure was put on Delaware, which led to the modification of its corporate law accordingly in 201370. Corporations that wish to be under this structure must specify at least one public benefit that they are going to pursue, to be more specific, the Delaware General Corporation Law states that "a 'public benefit corporation' is a for-profit corporation ... that is intended to produce a public benefit ... and to operate in a responsible and sustainable matter"71. Basically, effective July 16, 2020, firms may opt out and back in of shareholder primacy with a simple amendment of their charter. These types of firms have a managerial structure which is in accordance with the 'Triple Bottom Line'72. Directors in this case make trade-offs, balancing the interest of the stockholders and stakeholders with the overall objective of contributing to the public benefit they specified in the articles of incorporation73. Lastly, we must discuss the framework given by Mr. Lipton in the *New Paradigm*. This is "a roadmap for an implicit corporate governance and stewardship partnership between corporations and investors and asset managers to achieve sustainable long-term investment and growth..."74. This concept recognizes the importance of the board of directors and shareholders to be on the same page as other stakeholders. Naturally, all interests will be uniform if the background goal is longevity and long-term prosperity. If so, there should be little room for activism and short termism. "The framework of The New Paradigm is divided into three buckets:

First, *governance* is about the relationship between a company and its shareholders (asset managers and investors) and between company management and the board of directors. Companies will embrace core principles of good governance and, in cultivating genuine and candid relationships with shareholders, will be in a position to demonstrate that they have engaged, thoughtful boards overseeing reasonable, long-term business strategies.

[69] *See Gibranalnn*, *Benefit corporation,* Wikipedia (May 26th, 2021), available at https://en.wikipedia.org/wiki/Benefit_corporation.

[70] *See* David Yosifon, *Opting Out of Shareholder Primacy: Is the Public Benefit Corporation Trivial?*, 20 Santa Clara Law Digital Commons (Mar. 17th,2015), available at https://core.ac.uk/download/pdf/149271296.pdf.

[71] *See* General Corporation Law, Title 8, Public Benefit Corporations, DGCL § 361-368 (2013).

[72] Triple Bottom Line: business concept that breaks it down to the 'three Ps': profit, people and planet. Indicating that firms should commit to focusing on their social and environmental impact on top of financial performance.

[73] *Supra* note 1.

[74] See Martin Lipton, *It's Time to Adopt the New Paradigm,* Harvard Law School Forum on Corporate Governance (2019), available at https://corpgov.law.harvard.edu/2019/02/11/its-time-to-adopt-the-new-paradigm/.

Second, *engagement* is the exchange of information and requests between a company and its shareholders. Engagement is dialogue, not dictates from either side. Engagement connotes expectations around a two-way commitment between companies and shareholders to proactively engage with each other on issues and concerns that affect the company's long-term value and provide each other with the access necessary to cultivate long-term relationships. Companies commit to being responsive to the issues and concerns of shareholders, while shareholders will proactively communicate their preferences and expectations.

Third, *stewardship* is the relationship between shareholders (asset managers and investors) and a company. Stewardship reflects a commitment on the part of asset managers and investors to be accountable to the beneficial owners whose money they invest, and to use their power as shareholders to foster sustainable, long-term value creation. In embracing stewardship principles, asset managers and investors will develop an understanding of a company's governance and long-term business strategy and commit to constructive dialogue as the primary means for addressing subpar strategies or operations"75.

All of this outlines a traditional corporate structure which attempts to give solution to the managerial and governance issues in modern, day-to-day companies. We shall point out that this proposition, unlike for example the *Accountable Capitalism Act*, does not require any change in jurisdiction, which I might argue makes it a lot more feasible. In most of the points that Mr. Lipton uses in his argument, the concept of is the most emphasized76. *The New Paradigm* tries to change the mindset of the typical investor that thinks that time is money into a more participant and involved long-term supporter.

## 2. Managerial Side

The previous question that we have asked ourselves, for whom is the corporation managed has some relevance even in this aspect of the debate. No matter what the answer is, we must draw a line between the power of the stockholders and the directors. We have previously pointed out that the board of directors has various limits in context of takeovers, cases like *Revlon*

[75] *Id.*

[76] *See* Lenore Palladino, *The American Corporation is in Crisis—Let's Rethink It,* Boston Review (Oct 2nd, 2019), available at http://bostonreview.net/forum/american-corporation-crisis%E2%80%94lets-rethink-it/martin-lipton-new-paradigm.

supported this argument. However, in addition to the previously spoken of case of *Unocal*[77], there has been another trial which helps us better understand the vast number of possibilities that a management body of a corporation can take in order to avoid actions that would result in immediate short-term maximization instead of long-term growth[78]. In *Paramount v. Time*[79], Paramount Communications proposed an all-cash offer to buy Time incorporated, which was in the process of merging with Warner communication. The board of directors of Time rejected Paramount's proposal stating that the on-going merger was more promising under a long-term growth standpoint, and it did not serve a threat to Time's survival and 'culture'. Later on, Paramount and two other groups of shareholders initiated a lawsuit challenging Time's tender offer for 51% of shares of Warner communication. The court stated that the defendant had legitimately responded to a competing offer in a reasonable and proportionate matter[80]. This shows us how much influence the board of directors can have in the context of takeovers. There is empirical evidence that corporations allocate quarterly earnings differently when in a presence of a large shareholder[81]. There are different arguments on the matter, some support it and some criticize it. Some say that powerful stockholders can opportunistically intensify capital market pressure leading to the well-known by now unproductive allocation of capital and consequently, short-termism. Others however sustain that monitoring from powerful shareholders could bring to more short-term focus and productivity, leading to more growth in the long run[82]. Intensifying shareholder power can alleviate any issues with the management but can also be considered a 'double edged weapon'.[83] Logically shareholder primacy must not be seen as a possible strategy for the management of a corporation, but more of a background goal. As Jack Welch said, "*your main constituencies are your employees, your customers and your products, … increasing the value of your company in both the short and long term is an outcome of the implementation of successful strategies*"[84]. We can establish that there must be a relationship between the stockholder and the stakeholders to have

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[77] *Supra* note 60. To be more specific, the board of directors was given the possibility to repurchase from its stockholders selectively, if it is in good faith and with a specific motif.

[78] *Supra* note 13.

[79] *See Paramount Commc'ns, Inc. v. Time, Inc. - 571 A.2d 1140* (Del. 1989), https://www.lexisnexis.com/community/casebrief/p/casebrief-paramount-commc-ns-inc-v-time-inc.

[80] *Id.*

[81] *See* Katherine Guthrie & Jan Sokolowsky, *Large shareholders and the pressure to manage earnings*, Sciencedirect (Jun. 2010), available at https://www.sciencedirect.com/science/article/abs/pii/S0929119910000052

[82] We could think of an example of small firms not using well resources in the research & development phase of a project, taking more time that necessary.

[83] *Id.* at *81.*

[84] *See* Steve Tobak, *Does Jack Welch Think Shareholder Value is a Dumb Idea?*, CBS NEWS (Mar 25th, 2009), available at *https://www.cbsnews.com/news/does-jack-welch-think-shareholder-value-is-a-dumb-idea/*.

a productive, peaceful firm. Indeed, as we have discussed in the previous section, *The New Paradigm85* seems to be focusing a lot on this matter. We might argue that Mr. Lipton has tried to reach a corporate governance which isn't so different from the one that we have now in the
United States, but moreover it has tried to aggressively clarify that what needs to change is the approach individual entities with different roles have. Jamie Dimon, chairman and CEO of JPMorgan Chase has made several claims that indirectly support this, for example in an interview at Stanford University he said that: "bureaucracy drives out good people, it drives out innovation. It makes the person in the office next to you a competitor"86.
In conclusion, if Delaware's shareholder primacy doesn't imply short term value concentration and/or misallocation of revenues and under-investment, does it really matter to have a well-detailed and profound definition of what corporate purpose is and in whose interest it's managed for? Yes, the answer to this question is simple. By now it's common knowledge that Delaware corporate law is dominant in the United States87. Having shareholder primacy present in every modern corporation as well as Delaware's jurisdiction makes it inevitable not to be taught to the new generations in universities. I shall point out that I am not referring exclusively to universities of law, however it is natural that law has a great influence on how corporations operate. As a matter of fact, in one of Milton Friedman's most famous quotes that we have already cited he specifically says: "so long as it stays within the rules of the game"88.

## 3. Financial Side

Now that we have talked about what is being taught in universities and the influence that the concept of shareholder primacy has on the new generation, we shall also consider the fact that naturally, finance scholars also fall under this category. This movement that plans to move shareholders away from the spotlight implies some very serious consequences which might

[85] *Supra* note 74.
[86] *See Interview with* Jamie Dimon, Chairman and CEO of JPMorgan Chase, *by* Stanford Graduate School of Business, in Los Angeles, Cal. (Nov 9th,2017), available at https://www.youtube.com/watch?v=IyEadGANbgM.
[87] *See* Pierluigi Matera, *Delaware's Dominance, Wyoming's Dare. New Challenges, Same Outcome?*, 11 SSRN (Feb 18th, 2021), available at *https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3763106*.
[88] *Supra* note 15.

be extremes but must be considered. Until now, finance scholars are being taught directly and indirectly that corporations are run in the interest and the benefit of the stockholders. In addition to this, fundamental pillars of corporate finance include various theories that take time into consideration as a factor which negatively impacts the investment[89]. For example 'cherry-picking' investment projects with higher net present values doesn't really acknowledge long term growth positively like Mr. Lipton suggested. An important question indeed arises, if firms aren't run for shareholders, what is the unit of measurement of the performance of a corporation? Until now the stock price has been volatile, but an unbiased source to get this particular data[90]. An eventual restructure of the firm could damage the correlation between share price and potential; I might argue that this big of a radical change is unlikely to happen and therefore the answer to a question to whether if we should stop using the stock market as a metric for performance is no. The popularity that corporate social responsibility gained lately has put a great amount of pressure on corporations[91]. In 2015 study has been done on over than 1700 students from numerous institutes over the world, 92.1% of them thought that corporate social responsibility was so important that it could be even considered as a criterion when looking for a job. Half of these declared that they were willing to take a job with a 20% lower paycheck if in a socially responsible company[92]. Usually, these companies attract employees who are eager to make a difference in the world, therefore they might be more motivated and productive overall. In a large corporation with a great number of employees this could make a drastic difference[93]. However, CSR doesn't have only positive aspects, regulation of negative externalities is already complicated on its own, in addition a firm has its original purpose which is to maximize market shares and overcome competitors in its respective sector[94]. An article about

[89] *In finance, the net present value of a project takes the factor of time in consideration when evaluating the profitability of a project. In other words, NPV accounts for the time value of money.*

[90] *See* Jason Fernando, *Return on Equity (ROE)*, Investopedia (Nov. 30th, 2021), available at https://www.investopedia.com/terms/r/returnonequity.asp.

[91] *See* Kelsey Chong, *Millennials and the Rising Demand for Corporate Social Responsibility*, California Review Management (Jan 20th, 2017), available at https://cmr.berkeley.edu/blog/2017/1/millennials-and-csr/#:~:text=CSR%20reports%2C%20or%20publicly%20released,popularity%20over%20just%20four%20years.

[92] *See Why Millennials Choose CSR,* Newsroom, Morning Future (Aug. 16th, 2017), available at *https://www.morningfuture.com/en/article/2017/08/16/millennials-csr-companies-responsible/60/*

[93] *See Chris B. Murphy, Why Social Responsibility Matters to Business,* Investopedia(May. 3d, 2021), available at *https://www.investopedia.com/ask/answers/041015/why-social-responsibility-important-business.asp#:~:text=Being%20a%20socially%20responsible%20company,greater%20productivity%20in%20t he%20workforce.*

[94] *See by* Richard A. Clarke, Robert N. Stavins, J. Ladd Greeno, Joan L. Bavaria, Frances Cairncross, Daniel C. Esty, Bruce Smart, Johan Piet, Richard P. Wells, Rob Gray, Kurt Fischer, and Johan Schot, *The Challenge of Going Green,* Harvard Business Review (July, 1994), available at https://hbr.org/1994/07/the-challenge-of-going-green

the public corporations adapting stakeholder capitalism in their business models indeed says that: "While enthusiasm has been growing around these ideas in the business community, many companies are likely at a loss as to how to actually embrace them into their business models"[95]. Building a corporation that actively engages in increasing social welfare definitely creates a name with a strong reputation behind it, but can every corporation be held accountable for not having a social purpose? Nowadays corporate social responsibility is largely voluntary and has no specific laws that govern it. "Shareholders are more powerful than ever"[96], this is natural considering the fact that, as I have mentioned before, we are in a shareholder-oriented economy. These benefits granted by the legislation have created a lot of competitiveness in the financing and asset management world. Is it so hard to believe that this could change if the corporations stop acting with the purpose of generating value for their investors? For example, the previously cited *Accountable Capitalism Act* by Elizabeth Warren completely contradicts this. The intention to radically diminish under-investments and quarterly misallocated revenues leads to another doubt. The latter consequently leads to less potential dividends for shareholders, in other words, returns on investments. Will investors be given an incentive to look for opportunities in other countries where they have more legal advantages? Milton Friedman has been asked a quite relevant question on the matter of overseas competitors: "at the same time we have new co-operators which some people would refer to as new competitors coming into the system, so we have as you mentioned earlier a huge population mass of about 700 million working age Chinese and we have the Indians and then we have little countries that are eager to compete ... Should Americans be worried about this?"[97] The answer that he gave is undoubtedly highly debatable but quite gives an optimal sense to all of this: "quite the opposite, we should applaud it, we should try to make it more rapidly again it gives us an opportunity to make more use of our own special advantages, we have nothing to be afraid of, but everything to gain from it"[98].

[95] *See* Sustainable Brand, *Why to Adopt Public Benefit Governance with New Playbook, B Lab Outlines How* (Feb 10th, 2021), available at *https://sustainablebrands.com/read/walking-the-talk/b-lab-outlines-how-why-to-adopt-benefit-governance-with-new-playbook.*

[96] *Supra* note 56, at 17.

[97] *See Interview with* Milton Friedman, Nobel prize winner economist, by Dallas Fed (Oct 19th, 2005), available at https://www.youtube.com/watch?v=ZJfrWSYXu3A.

[98] *Id.*

## 4. Political Side

The political aspect of this matter coincides with the one we have just talked about, revolving mostly around Senator Elizabeth Warren and the role of corporations for United States' economy. The *Accountable Capitalism Act* cannot stress enough the concept of under investment. All American Companies, especially the biggest ones have dedicated 93% of their revenues to shareholders for the last decade. This has redirected trillions of dollars which could've been used for re-investing in employees or long-term investments. American companies being under-invested creates unnecessary opportunities for foreign competitors. Overall, 84% of American-held shares are owned by the top 10% of American households meaning that it's the rich people that keep getting richer[99]. Macroeconomic programs teach that by mis-allocating resources you will lose a respective amount in optimal output in the future[100]. This is the most evident point, under-investment had an immensely negative impact in the growth of the national gross domestic product of the United States. The remedy that the bill proposes is to force largely impactful corporations to obtain federal charters which imply the consideration and proper investment towards all stakeholders. Secondly, corporations have also an educational purpose for the new generations to get involved and start building competency. The under-investment towards employees could also hurt this side of the spectrum, meaning that the focus on stockholder value could lead to even harming themselves, collectively and over time[101]. The concept of benefit corporations that we have discussed upon before has some points in common, shareholders know that they cannot initiate a lawsuit in the case of using corporate resources for these alternative objectives[102]. Critics have discussed a negative aspect of this bill: "This arrangement may resemble Senator Warren's federal charter but it is voluntary not compulsory and instead of dictating what the company will consider, as Senator Warren's law would, it allows the corporation to choose which other priorities its charter will include"[103]. One of the biggest, most influential steps towards stakeholderism was taken by the Business Roundtable, however have the corporations of the

[99] *Supra* note 31.

[100] *See* Andrew Bloomenthal, *Production Possibility Frontier (PPF),* Investopedia (Nov 7th, 2021), available at https://www.investopedia.com/terms/p/productionpossibilityfrontier.asp.

[101] *Supra* note 47, at 10.

[102] *Supra* note 70.

[103] *See* Milton Ezrati, *Senator Warren's Accountable Capitalism Bill Has Big Problems,* Forbes (Feb 5th, 2019), available at https://www.forbes.com/sites/miltonezrati/2019/02/05/senator-warrens-accountable-capitalism-bill-has-big-problems/?sh=24aa8dce471b

signatory CEOs been coherent with what they stated? The resemblance between their statement and the *Accountable Capitalism Act* is evident, indeed Elizabeth Warren herself has interacted through a very powerful letter in which she "urged BRT to fully commit to the principles they set out in the 2019 statement, act on them, and publicly report on their progress in the coming year. She also called on them to reconsider their hostility to the common-sense reforms proposed in her Accountable Capitalism Act"104. Not many members of the BRT have answered. A study has been done on the matter, *Do The Socially Responsible Walk the Talk? 105*
provides strong points both to supporters and critics. In the latter they described how the signatory firms continued to "exhibit worse federal compliance records than matched non-signatory firms as well as higher carbon emissions intensity"106. At the end of the day, the commitments made were entirely focused on social welfare so it's natural that they will have a bigger impact on people, therefore they might just want to know if their intentions match their publications107. Undoubtedly a solution to these national issues is way more
complicated than the ones previously argued. Corporations can be incorporated in different jurisdictions so finding a solution for all the United States would have to include the federal government to come into play and dictate a common regulation. On the top of it, we can gladly say that technology is lowering barriers of entry for international markets which was arguably incentivized by the pandemic that we currently live in108. We come back again to a question that we have already seen but under a different standpoint, would corporations be incentivized to incorporate outside the United States if found at a disadvantage in respect to international competitors that operate in America?

## III. The Rise of Stakeholderism

Now that we have discussed the history of this debate including the origins and how it developed, theoretically and practically as well as what impact it had on all macro aspects, we shall analyze how it developed after this re-ignition. After particular events that we are going

104
*Supra* note 27.
105
*See* Aneesh Raghunandan, Shivaram Rajgopal, *Do Socially Responsible Firms Walk the Talk?*, University of Faculty of Oxford Law (June 3d, 2021), available at https://www.law.ox.ac.uk/business-law-blog/blog/2021/06/do-socially-responsible-firms-walk-talk.
106
*Id.*
107
*See* Robert G. Eccles, *An Open Letter To The Business Roundtable 181*, Forbes (Aug. 19th, 2020), available at https://www.forbes.com/sites/bobeccles/2020/08/19/an-open-letter-to-the-business-roundtable-181/?sh=7084c3fb4001.
108
*See* Unctad, *Covid-19 and E-Commerce: A Global Review,* 80 Unctad (2021), available at https://unctad.org/system/files/official-document/dtlstict2020d13_en.pdf.

to discuss further into the paper, we can without a doubt say that public pressure really showed great influence, up to a certain point to which stakeholderism has arisen after more than 35 years of American shareholder primacy[109]. It began only theoretically, in a relatively slow manner but is now accelerating more and more. To strengthen this point, the Security Exchange Commission has taken certain decisions which give the idea that its hesitant on taking this side. The former movement, which is aligned to Professor Dodd's initial take on the matter as well as Professor Berle's final theory[110], is denoted as ESG. The former stands for: Environmental, Social and Governance. These three fields have all sub-concepts which are all merged into this acronym. Environmental examines how the corporation operates with respect to the environment, for example focusing on pollution, waste and in general other types of externalities. Social, which comprises how it treats people including employees, customers and all the interests that come with them[111]. Governance concentrates on how the internal structure or policies of a firm are built. The former concerns concepts like tax strategies, compensation packages, bribery, honesty and so on[112].

The ESG factors of a firm are especially looked at as an evaluation process, analyzing how advanced they are with sustainability but in general, how they operate with respect to all stakeholders[113]. This sort of analysis got its importance as it was commonly utilized when cherry-picking investments. As a matter of fact, the term 'ESG' was first mentioned in 2006 in the United Nation's Principles for Responsible Investment (PRI) report[114]. There, it was first questioned the need to have ESG criteria present in financial evaluations of companies to indeed facilitate investors' sustainable investments.

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[109] *See* Andy Hartwill, *ESG beyond E - the rise of stakeholder governance*, Simmons-Simmons (May 27th, 2021), available at https://www.simmons-simmons.com/en/publications/ckp3y0u2m1n4x0954rcbcdz6x/esg-beyond-e---the-rise-of-stakeholder-governance

[110] *Supra* note 14.

[111] *See* Robeco, *What is ESG?*, Robeco (last visited May 8th, 2022), available at https://www.robeco.com/en/key-strengths/sustainable-investing/glossary/esg-definition.html. *available at*

[112] *See* Market Business News, *What is ESG? Definition and meaning,* (*last visited* Mar. 27th, 2022), What is ESG? Definition and meaning - Market Business News.

[113] *See* Robeco, *What is ESG?(last visited Mar. 27th, 2022), available at* https://www.robeco.com/en/key-strengths/sustainable-investing/glossary/esg-definition.html.

[114] *See* Betsy Atkins, *Demystifying ESG: Its History & Current Status*, Forbes (Jun. 8th, 2020), available at https://www.forbes.com/sites/betsyatkins/2020/06/08/demystifying-esgits-history--current-status/?sh=480552922cdd.

## *A. Environmental, Social, Governance*

### 1. Introduction to ESG

After decades of shareholder primacy, the long-standing debate has concretely taken a new form. I specified 'concretely' because up until now the concept of stakeholderism, was only present in many discussions in a theoretical way, while now, it is starting to get the importance people think it deserves in terms of jurisdiction115. As time passes these factors relative to society and sustainability are gaining more and more importance due to the impact they have on the stock market. Why is this the case? Arguably, one of the reasons is technological development. Companies cannot 'hide' anymore when it comes to acting unconsciously regarding the environment or mistreating any type of stakeholder. Any mistake now has a much bigger impact on stock pricing than it had 10 years ago, indeed, what society demands is that corporations internalize cost of externalities. This is the main reason why sustainable investing is becoming more and more efficient. The latter has shown to have no trade-off in terms of return, but at the same time have a lower average risk116. Nowadays, it has become a proper strategy for investors to scrutinize ESG factors when evaluating a firm117 and when this information is missing, they commence to demand it. In 2004, a group of 20 financial institutions published and marketed a report entitled 'Who Cares Wins: Connecting Financial Markets to a Changing World'118. This report had the underlying message of recommending integration of Environmental, Social and Governance value drivers in financial market research, analysis and investment. Following the matter, a year later, the term 'ESG' was first coined as an evaluation process of corporations regarding their social goals which go beyond the recurring goal of maximizing profits119. Even though this was the first time by which this process and term were officially attributed to a concept, we can tie the development

115 *See* Emma Newburger, *ESG AND GREEN BUSINESS SEC unveils rules to prevent misleading claims and enhance disclosures by ESG funds*, CNBC (May 25th, 2022), available at https://www.cnbc.com/2022/05/25/sec-unveils-rules-to-prevent-misleading-claims-by-esg-funds-.html#:~:text=The%20SEC%20on%20Wednesday%20proposed,disclosure%20requirements%20for%20those%20funds.

116 *See* Morgan Stanley, *Sustainable Reality: Analyzing Risk and Returns of Sustainable Funds*, 1 (2019), https://www.morganstanley.com/content/dam/msdotcom/ideas/sustainable-investing-offers-financial-performance-lowered-risk/Sustainable_Reality_Analyzing_Risk_and_Returns_of_Sustainable_Funds.pdf.

117 *See* CFA Institute, *ESG Investing and Analysis*, CFA Institute (*last visited* Apr. 12), available at https://www.cfainstitute.org/en/research/esg-investing

118 *See* The Global Impact, *Who Cares Wins 2005 Conference Report: Investing for Long-Term Value,* 1 (2005), https://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/sustainability-at-ifc/publications/publications_report_whocareswins2005__wci__1319576590784.

119 *See* Nish Oxa, *Environmental, social, and corporate governance, Wikipedia* (May 12th, 2022), available at https://en.wikipedia.org/wiki/Environmental,_social,_and_corporate_governance

of this ideal to many historical events120. The practice of ESG can be broadly tied up to the 1960s when individuals were commencing to invest in a socially responsible matter. In this case, it began with people being opposed to the Vietnam war as well as the civil rights movement121. This was strengthened even more as people were starting to exclude corporations involved in tobacco and alcohol production, but most importantly, diverging from firms involved in South African apartheid122 regime from their portfolios123. Later in the 1990s,

the Domini 400 Social Index was founded by KLD's Amy domini124. The former was designed to help socially conscious investor acknowledge environmental factors to make their investment choices. Now, the renominated 'MSCI KLD 400' represents 400 publicly traded companies that maintain high ESG ratings125. As we can observe, the matter at hand isn't a newly discovered theory, on the contrary, it has been present for a long time but it has re-ignited due to various events that happened in the last decade which brought it to an immense amount of external pressure. I could argue that this re-ignition isn't the only reason that caused the latter. On one side we have the concern by society on environmental issues which push as hard as they can on sustainability, like global warming for example. On the other hand, we have the immense difference in the ease of communication as technology keeps on developing. This type of pressure is mostly produced by investors that prefer socially responsible investments, as well as the public.

[120] *See* Kayla Barnes, *A History of How Modern ESG Came to Be,* sgENGAGE (May 6th, 2021), available at ESG Timeline: A History of Environmental, Social & Governance Programs (npengage.com)

[121] *See* Tom Fanter, Andy Baker & Chriss Graff, *The History & Evolution of ESG*, RMB Capital (Dec. 15th, 2021), available at https://rmbcapital.com/news-insights/history-evolution-esg

[122] Apartheid was an imposed system of rule based on racial segregation that lasted from 1948 to 30 June 1991 in South Africa.

[123] *See* MSCI, *The Evolution of ESG Investing* (*last visited* Apr. 15th, 2022), *available at* https://www.msci.com/esg-101-what-is-esg/evolution-of-esg-investing#:~:text=The%20practice%20of%20ESG%20investing%20began%20in%20the,or%20involvement%20in%20the%20South%20African%20apartheid%20regime.

[124] *See* Narky Blert, *MSCI KLD 400 Social Index,* Wikipedia (*last visited* Apr. 15th, 2022), available at https://en.wikipedia.org/wiki/MSCI_KLD_400_Social_Index

[125] *See* Jason Fernando, *MSCI KLD 400 Social Index*, Investopedia (Dec. 3d, 2020), available at https://www.investopedia.com/terms/d/domini_400.asp#:~:text=The%20MSCI%20KLD%20400%20Social%20Index%2C%20previously%20known,as%20employee%20and%20human%20relations%2C%20product%20safety%2C%20

## 2.Sustainability Reporting and ESG Integration

The public demand for greater transparency on sustainability and the cost of firms' externalities is constantly growing126. In addition to the former, stock exchange regulation and investment pressure incentivizes the presence of non-financial information into any corporation annual report. Indeed, 78% of the greatest 250 companies disclose sustainability in their annual reports as they believe it is of great relevance for investors127. A remarkable event which facilitates the process of ESG reporting was the SASB and IIRC merger which integrated the three resources using a common language. Value reporting foundation CEO Janine Guillot stated: "By more closely aligning the Integrated Reporting Framework and the SASB Standards the Value Reporting Foundation will make it easier for businesses to communicate their long-term strategy and provide a more comprehensive view of business performance to investors and other providers of capital"128.

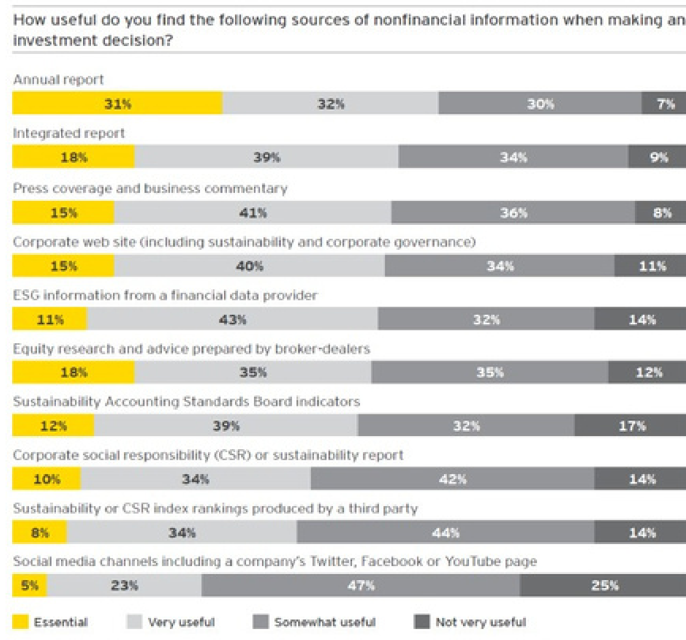
In the figure below, we can see the results of a survey that shows us how non-financial information is seen by the respondent investors129. Interestingly, 31% find it essential while 32% find it very useful to analyse non-financial information in the annual report. The survey and the corresponding image are very clear, therefore, let's get straight to the point. Socially responsible investing has grown so much over the years that it isn't a trend anymore, on the contrary, it is the strategy of both the experienced and the occasional investor.

[126] *See* Maeve Millwood, *Demand is growing for increased transparency on impacts*, Oiseal (June 21st, 2021), available at https://www.isealalliance.org/sustainability-news/demand-growing-increased-transparency-impacts#:~:text=Key%20drivers%20for%20increased%20transparency,readily%20available%20and%20not%20misleading.

[127] *See* Visvesh Sridharan, *Bridging the Disclosure Gap: Investor Perspectives on Environmental, Social & Governance (ESG) Disclosures,* SSRN (Jun. 27th, 2018), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3180412

[128] *See* April Hall, *SASB and IIRC Merge to Create Consistent ESG Reporting,* Directors&Boards (*last visited* May 1st, 2022), available at https://www.directorsandboards.com/articles/singlesasb-and-iirc-merge-create-consistent-esg-reporting

[129] *See* Mathew Nelson, *Is your nonfinancial performance revealing the true value of your business?,* EY (Mar. 30th, 2017), available at Is your nonfinancial performance revealing the true value of your business? (ey.com)




Due to this relevance, also guidelines for this type of disclosure have developed. The most used is the Global Reporting Initiative (GRI) which sets out a framework that guides disclosure in a multi-stakeholder approach[130]. The sound of this could appear to not have many costs but it is of great challenge to even partially satisfy all stakeholders which likely have different objectives and concerns and on the top of it, collecting and assuring the accuracy of data requires great effort, especially for large corporations. ESG integration is becoming more and more of a common topic into corporate boardrooms. Directors work on implementing these new concerns into a corporate strategy but many, insert them also as an employee compensation structures, often being referred to as 'ESG metrics'. Incentives have mostly been tied up to financial related goals like a firm's revenue, cashflow or shareholder return but this shift to non-financial objective is recently becoming more and more common[131]. Nowadays, around 45% of FTSE 100 companies have already adopted this change in their compensation structure[132]. Inevitably, there is some disagreement among shareholder to which extent they prefer of having this sort of ESG integration. There have been various

[130] *See* Barbara Strozzilaan, *ESG standards, frameworks and everything in between,* GRI (March 10th, 2022), available at https://www.globalreporting.org/media/jxkgrggd/gri-perspective-esg-standards-frameworks.pdf.

[131] *See* Maria Castañón Moats, Leah Malone, and Christopher Hamilton, *The Evolving Role of ESG Metrics in Executive Compensation Plans,* Harvard Law School Forum (Mar 19th, 2022), available at The Evolving Role of ESG Metrics in Executive Compensation Plans (harvard.edu).

[132] *id.*

PwC's Global investor surveys which illustrate various points but two of these really caught my eye.

First, investors are becoming more willing to act if companies aren't properly addressing ESG issues133. This shows how also shareholders are behind this concept. This could be either because they believe in the cause or simply rely on the fact that it could be a non-excludable concept from business strategy. However, thanks to the next survey/figure, we will see what happens when shareholder value is at stake for the matter.

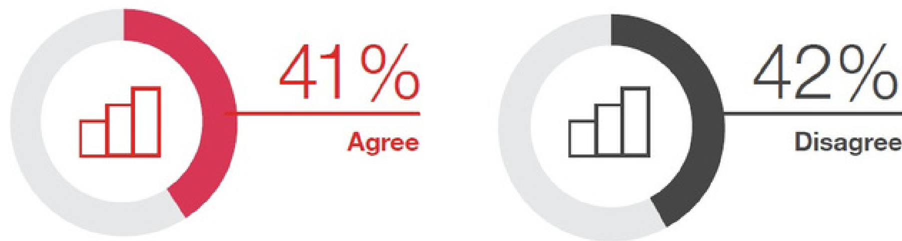
Secondly, shareholders aren't so convinced regarding this internal integration of ESG, especially if it has a chance of influencing shareholder value in the long run. Indeed, we can see in the following figure that there is an equal disparity among shareholders134.

[133] *See* James Chalmers, Emma Cox, Nadja Picard, *The economic realities of ESG, PWC* (Oct. 28th, 2021), available at https://www.pwc.com/gx/en/services/audit-assurance/corporate-reporting/esg-investor-survey.html

[134] *Id.*

**ESG metrics vs. long-term shareholder value**

Investors are split that ESG performance measures should be included even if the targets conflict with long-term shareholder value




Source: PwC, *Global investor survey*, December 2021.

Are shareholders contrary to this movement really in the wrong? This could be an example of what commentator H.L. Mencken stated: "every complex problem has a solution which is simple, direct, plausible—and wrong"[135].

## *B. The Practical View of ESG Integration*

### 1. The Use and Limits of ESG Metrics in Executive Compensation

ESG metrics are often used as performance objectives when determining annual cash bonuses[136]. The structure of executive compensation is fundamental to assess corporations' objectives to directors for two reasons. Firstly, the most evident one is that compensation structure will incentivize directors with either a greater pay or something equally influential. Secondly, the design of compensation strongly highlights what are the main focuses of a corporation. Therefore, the compensation structure can have a great influence on the internal side of a corporation and that is why most supporters of stakeholderism push this sort of integration[137]. To observe the efficacy of this tool, it would be optimal to study the impact caused by the operational change in the companies that had their CEO sign the BRT statement[138] which was one of the major events viewed as a turning point for corporate

[135] *See* Tom Gosling & Philippa O'Connor, *Executive Pay and ESG Performance,* Harvard Law School Forum (Apr. 12th, 2021), available at Executive Pay and ESG Performance (harvard.edu)

[136] *See* Maria Castañón Moats, Leah Malone, and Christopher Hamilton, PricewaterhouseCoopers LLP, *The Evolving Role of ESG Metrics in Executive Compensation Plans*, Harvard Law School Forum on Corporate Governance (March 19th, 2022), available at https://corpgov.law.harvard.edu/2022/03/19/the-evolving-role-of-esg-metrics-in-executive-compensation-plans/.

[137] *See* Lucian A. Bebchuk & Roberto Tallarita, *WILL CORPORATIONS DELIVER VALUE TO ALL STAKEHOLDERS?,* 5 (2022), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3899421.

[138] *Supra* note 7.

America. These firms, with an aggregate market value of $13 trillion, would've had a significant impact if showed commitment to stakeholders139. Interestingly, not many of these CEOs have adopted ESG in their compensation structure and/or their corporate strategy and,
indeed, the BRT statement was described in *The Illusory Promise of Stakeholder Governance* as: "mostly for show, largely representing a rhetorical public relations move, rather than the harbinger of meaningful change"140. Nevertheless, it was found to be that by 2020 already 52.6% of S&P 100 companies had adopted already these metrics. So, can we say that it has had a great, positive impact on stakeholders without compromising shareholder value in the long run? The question we will be asking ourselves in the remaining part of this chapter is specifically this one: Would the expansion of the increase of this methodology of compensation structure have an improvement of stakeholder welfare without being costly for the internal side of a corporation and, hence, the shareholders? Initially, the first matter that comes to mind when even discussing this solution is that stakeholders have been narrowed down to one group like shareholders, but they logically do not have the same resemblance of interests. To further explain myself, up until now we had shareholder primacy which concretely requires to satisfy the interest of the group of investors which at the end of the day, is to maximize the value of their involvement, equity or simply, investment. To do so, there have been various cases that we have initially introduced141 that affirmed the fact that the board
of directors had freedom of choice to even go against certain shareholders that had a different interest from their group which was to maximize the firm's value in the long run. On the other side of the coin, if we had to include stakeholders' interest in executive compensation, we would have to narrow down the interest of all stakeholders to add a certain metric. Supporters of stakeholderism, as well as the BRT in their 2019 statement142, have referred to stakeholders as anything that is impacted or is part of a corporation. Therefore, they could range from the employee to the residents near the production facility of a hypothetical company. But how could we then narrow down those interests? The interest of an employee includes their: wage, which must not be diverse from their equal because of any racial or gender distinction; Work Environment which must be safe, inclusive; Protection in case of unemployment; and so forth. The interest of a customer on the other hand would be more

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[139] *See* Lucian A. Bebchuk & Roberto Tallarita, *THE ILLUSORY PROMISE OF STAKEHOLDER GOVERNANCE*, 5 (2022), https://corpgov.law.harvard.edu/2020/03/02/the-illusory-promise-of-stakeholder-governance/.

[140] *id.*

[141] *Supra* note 60.

[142] *Supra* note 53.

concentrated on: having a product of quality which is sustainable; having a safe shopping environment (e.g. Covid-19 precautions); a customer service after having purchased the good; and so forth. These are only two of the great group of stakeholders that we have highlighted since all society could be included with that type of classification. Nevertheless, the most important point to get out of this is that stakeholders could have conflicting interests between each other and, even if that wasn't the case, finding a metric that would include or simply positively affect all those interests would require detailed analytic theorizing even if, it could be argued that, it would be so difficult it could be even considered to be impossible. Because of this, ESG metrics are limited and narrow. Business leaders like in the Business roundtable statement have claimed that all stakeholders are essential and must be thought about equally. Realistically however, corporations that decide to take this benevolent route, only choose a few groups to resemble their stakeholders and try to identify aspects of their welfare which are correlated and focus on those. Previously, we have anticipated that there is
pressure on companies to integrate ESG, either in their corporate strategy or in executive compensation. However, it must be done in the right manner, having the right objective to positively affect stakeholder welfare but at the same time not being costly for the corporation CEOs and directors. Having this concept inserted in executive compensation would allow the board of directors to hold CEOs accountable for their company's behavior and decision-making with respect to stakeholders. However, there are various doubts that arise with this type of integration. One of the main problems of ESG metrics is often referred to as the multitasking problem[143]. We have many interests which concern stakeholder welfare; hence, this problem consists in the normal human behavior which could lead CEOs to emphasize efforts onto certain factors which aren't considerably more important, but simply more measurable. Measurability in these fields can be complicated and, on the top of it, also manipulable. By manipulable I mean that there could be ways to get the results desired onto the utilized metric but in a way that it doesn't create value for stakeholder welfare. If a CEO must be concerned by increasing the average wage in his own company, he could exclude or fire the lowest played employees in order to meet his objective while not committing to any stakeholder. An example of this can be seen at Marathon Petroleum. In this peculiar case, its CEO was awarded $272,000 as a bonus for surpassing some previously set environmental objectives and was awarded for: "excellence in environmental, personal safety and process safety

[143] *See* experiment conducted a field experiment with factory workers in China coherent with the multitasking theory. Fuhai Hong, Tanjim Hossain, John A. List & Migiwa Tanaka, Testing the Theory of Multitasking: Evidence from a Natural Field Experiment in Chinese Factories, 59 INT. ECON. REV. 511 (2018).

improvement"144. This has happened the same day in which their company has spilled 1,400 barrels of fuel in an Indiana Creek145. But why did this happen if it was one of the worst oil spills in years? The ESG metric was focusing on number of oil spills and not quantity of oil spilt. This is exactly what I mean when I say that one of the complications in ESG metric is establishing one that respects stakeholders' interests but at the same time worries about measurability. Secondly, we look at an executive compensation from another point of view. "The Economic Policy Institute found that CEO pay has skyrocketed 1,322% since 1978. In 2020, CEOs were paid 351 times as much as a typical worker, a year when 114 million jobs were lost due to the COVID-19 pandemic. This surge in CEO pay has aided the expansion of the incomes of the top 1%, leaving less economic growth opportunities for ordinary workers and widening the income gap between the top 1% and the bottom 90%"146. The former is consequence of them having considerable amounts of power on the board of directors and being able to use it to get excessive amounts of compensation147. We see that executive pay is fairly

scrutinized from non-members of a corporation. It would be optimal for the group of shareholders to keep an eye on CEOs under this point of view but that isn't always the case. In most scenarios shareholders aren't interested or are too many to have power on this sort of matter. This scenario often relies on other participants in the market which exert pressure publicly to single-handedly regulate it148. The former isn't so easy as it sounds since the compensation structure of a company isn't always public information, in fact, transparency is what strengthens the power of the market. As a matter of fact, investors and analysts constantly pressure companies to disclose this information to make sure that abusive or outrageous behavior is happening. This concept has developed different types of disclosure regulation on the matter. First, the SEC requires public companies to disclose compensation paid

to CEOs (as well as how is it formulated) and other high-ranking executives in their organizations. This information is usually found in company's annual proxy statements, annual

144 *See* Douglas MacMillan & Julia Ingram, *Despite spills and air pollution, fossil fuel companies award CEOs for environmental records*, The Washington Post (Oct. 10th, 2021), available at https://www.washingtonpost.com/business/interactive/2021/fossil-fuel-climate-bonus/

145 Supra note 111.

146 *See* Michelle Winters, *ESG & executive pay: A look inside the trend,* Goby Is Now (Jan 31st, 2022), available at https://www.gobyinc.com/esg-executive-pay-a-look-inside-the-trend/

147 For an early overview of this problem, see Lucian Bebchuk & Jesse Fried, Pay without Performance: The Unfulfilled Promise of Executive Compensation (2004), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=537783.

148 *See* Gregory L. Nagel, Denise M. Leggett, *The Effect Of Social Pressures On CEO Compensation*, Core (Sep. 15th, 2015), available at https://core.ac.uk/download/pdf/268105483.pdf.

report on form 10-K and in registration statements for the public sale of securities[149]. To give an example, a company's proxy statement includes fundamental information regarding executive pay, ranging from: the amount and the type of compensation paid to CEO, CFO and the three other highest paid executives; all the way to the comparison of their compensation to the median of employees working in that company; as well as how all these numbers are established. Secondly, the say-on-pay rule requires public companies subject to proxy rules to provide their shareholders with an advisory vote on the compensation of the most highly compensated executives. These votes must be held every three years, even if most companies decide to hold them yearly[150]. This was implemented so that shareholders were facilitated and almost pushed to have a closer look at directors' pay. Even if the vote is strictly for suggestion, it shows cases in which there is the investor disapproval and that some actions must be taken in the other direction by management. The former has also proven to incentivize directors to go out of their way to inform shareholders before the say-on-pay meeting to improve chances of a favorable vote. As times have passed, investors and advisory have managed to build a standard for executive pay and therefore can be quick to judge the compensation structure of a company[151]. For this matter, since we are looking for the first time at the implementation of the interests of stakeholder welfare and not of shareholders anymore, what better than have the stakeholders themselves comment on this structure. Therefore, to build a proper and functional ESG metric, we can conclude that it is fundamental to be transparent and accept the critics of other market participants[152]. Before heading to next topic of discussion which will include what is being suggested to corporate board rooms and how these metrics are practically being implemented, I'd like to conclude this chapter with a quote that almost gives an introduction for the next part. "One of my big fears about this sort of stampede towards including ESG targets in executive pay is that it's likely just to lead to

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[149] *See* Longnecker Associates, *Disclosure Requirements, SEC Compliance & Creating Effective Disclosures, Longnecker & Associates | All-in* last visited (May 10th, 2022), available at https://www.nfpcompensationconsultants.com/strategy-governance-advisory/executive-compensation-disclosures/.

[150] *See* SEC Editing Team, *Investor Bulletin: Say-on-Pay and Golden Parachute Votes*, SEC (Mar. 2011), available at https://www.sec.gov/files/sayonpay.pdf

[151] *See* Justin Kuepper, *Evaluating Executive Compensation*, Investopedia (Dec 4th,2021), available at https://www.investopedia.com/articles/stocks/07/executive_compensation.asp

[152] *See* Ira T. Kay, Chris Brindisi, Blaine Martin, Soren Meischeid, and Gagan Singh, *The Stakeholder Model and ESG,* Pay Governance (Sep. 1st,2020), available at https://www.paygovernance.com/viewpoints/the-stakeholder-model-and-esg

more pay and not more ESG. And we need to recognize that as a potentially big unintended consequence."153.

## 2. Implementing ESG Into Modern Day Corporations

The pressure from the public had a great influence as the percentage of public companies implementing ESG is rising and not slowing down154. The former isn't necessarily positive as it could consist of meaningful actions or blatant greenwashing. To eliminate even the belief that this is not built only of pure and stakeholder-oriented actions there should be full and in-depth disclosure by corporations' board of directors when answering the inevitable questions of stakeholderists, or to be broader, the public. The main issue at hand that we have highlighted before is making the best decision on which metric benefits more stakeholders' interest at

once,
while also being measurable. A good example of this inclusion is the telecommunication firm named Verizon155. In 2020 they have utilized three different ESG metrics: workforce diversity, diverse supplier spending and carbon intensity reduction. To this day, they have published on their website a specific page entitled 'ESG Resource Hub' where they publish all news relative to this matter with the specific message: "Our Environmental, Social and Governance (ESG) strategy is to effectively govern and manage the environmental and social risks and opportunities that arise from our core business strategy. We are dedicating our assets to creating a positive impact in a sustainable way, while fostering a culture based on integrity and respect"156. By seeing their constant commitment to ESG we can deduce that it is having a positive effect on their corporation at the end of the day. If this change of strategy would've caused some loss on resources, it surely wouldn't have followed the following years. What we are sure of is that their corporation has obtained a very positive reaction reputation-wise and is being looked at as an example from other firms which are looking to adopt ESG. Unfortunately, not all cases are like the this. Operating at this business level, even with good intentions, could be worse than operating at all. We pointed out before

153 *See* CJ Clouse, *Does linking ESG performance to executive pay actually make a difference?,* GreenBiz (Feb. 2, 2022) available at https://www.greenbiz.com/article/does-linking-esg-performance-executive-pay-actually-make-difference

154 Supra note 109.

155 *See* Beth Sasfai, *Verizon: Sending a Strong ESG Signal to Investors*, Value Reporting Foundation SASB Standards (Oct. 20th, 2020), available at https://www.sasb.org/blog/verizon-sending-a-strong-esg-signal-to-investors/.

156 *See* Verizon Editing Team, *ESG Resources Hub,* Verizon (May 17th, 2022), available at https://www.verizon.com/about/investors/ESG-resources-hub

the executive compensation accident by Marathon Petroleum157 which is more than a proper example. For these reasons, the more emphasized advice that is given to corporate board rooms is to not rush into this integration because of the recent trend but instead, scrutinize all information and data available to take the best possible approach at this. On the other hand, it is a lot easier to integrate ESG when a firm is small and has less attachments rather than when it is larger. Nowadays, like it or not, the idea that profit and purpose must go hand in hand is crucial for companies and "the ones that recognize this are the ones that will be the business leaders of the future"158. This inclusion has now been discussed under different point of views by now, negatively and positively, however, this can be seen as a real and proper opportunity if everything is done with the necessary diligence and strategy it could lead to concrete advantages against competitors. These range from the most evident which are: a change in how a firm is looked at from society, in other words, reputation which leads to customer loyalty and appeal; labor force; and so on. Another advantage mentioning which is very important and not so apparent is the desirability of mergers and acquisitions from other corporations which is incredibly affected by how firms are evaluated with ESG factors. As a matter of fact, it has also been proven that low ESG companies tend to significantly improve their performance after the involvement with a high ESG firm159. Indeed, evaluation under this point of view plays a decisive role in every step of a takeover process. Starting from target selection, due diligence and valuation, deal completion and post-merger integration. A survey conducted by KPMG reveled that is these factors give cause for concern, firms that are looking to acquire mostly walk away early in the deal process. Why? Another study still at KPMG showed that 76% of 1300 surveyed CEOs consider environmental risks as the biggest threat to business growth160. Indeed, it's becoming more than a trend to emphasize the importance of carrying out a separate ESG due diligence as an integral part of the takeover process. The rationale for the former is quite simple to comprehend, generally, corporations with good ESG management tend to have full disclosure of it to the public, showing more transparency reducing information asymmetry that instead could be more present in a traditional firm and

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157 *Supra* note 144.

158 *See* Socialsuite, *Meet the companies embracing ESG reporting: what is it and how can your business benefit?*, The Guardian (Sep. 13th, 2021), available at https://www.theguardian.com/stocks-digital-esg-reporting-comes-of-age/2021/sep/13/meet-the-companies-embracing-esg-reporting-what-is-it-and-how-can-your-business-benefit

159 *See The role of ESG in acquirers' performance change after M&A deals* Xuan Feng, , AIMS Green Finance (Aug. 17th,2021), available at https://www.aimspress.com/aimspress-data/gf/2021/3/PDF/GF-03-03-015.pdf.

160 *See CEOs name climate change as number one risk to organizational growth*, KPMG Editing Team, KPMG (Sep. 22nd, 2019),available at *https://home.kpmg/xx/en/home/media/press-releases/2019/09/ceos-name-climate-change-as-number-one-risk-to-organizational-growth.html*

having consequently, more stakeholder management. In many cases of mergers or acquisitions, stakeholders tend to be put to the side or simply placed below the level of the shareholders[161]. This is another example by which something has mostly been of primarily to concern for the shareholders, has started and could start to give more attention to stakeholders. The inclusion and concern for ESG factors gives the same interest for stakeholders in this type of processes and can take different shapes as for example the status of the target corporation to the payment method utilized to acquire the first shares of the takeover.

## *C. The Security Exchange Commission Proposal*

### 1. A Change to Disclosure Regulation

As we've said multiple times by now, various studies have proved that sustainable investments have provided greater returns for investors as well as mutual funds. The appeal for sustainable investments has caused movement across the spectrum, starting from the internal structure of corporations that want to attract more investors to invest in their company to regulation from the government and the securities exchange commission that want to push this movement even further than the market alone can do[162]. In March, the then-acting Chair Allison Herren Lee announced that the Security Exchange Commission will be "working toward a comprehensive ESG disclosure framework offering guidance on human capital disclosure to encourage the reporting of specific metrics like workforce diversity and considering more specific guidance or rule making on board diversity"[163]. On June 16, 2021, the United States house of representatives, usually known as 'The House' passed the "Corporate Governance Improvement and Investor Protection Act" which is a collection of several different bills that essentially demand for companies to disclose substantial ESG metrics in various issuer materials. Still in June 2021, the G7 Finance Ministers and Central Bank Governors committed to addressing these ESG challenges and publicly disclosed their intentions to

[161] *Supra* note 43.

[162] *See* Veronica Poole & Kristen Sullivan, *Tectonic shifts: How ESG is changing business, moving markets, and driving regulation,* Deloitte (Oct. 29th, 2021), available at https://www2.deloitte.com/us/en/insights/topics/strategy/esg-disclosure-regulation.html

[163] *See* Paul | Weiss, *Acting SEC Chair Lee Discusses Additional Climate and ESG Initiatives* (Mar. 17th, 2021), available at https://www.paulweiss.com/media/3980903/acting_sec_chair_lee_discusses_additional_climate_and_esg_initiatives.pdf

publish a global standard that could serve as a standard guideline for corporations. The former point was then supported by G20 in July[164]. The same month, SEC chair Gary Gensler came out and stated that he demanded mandatory climate-disclosure regulation. He followed up saying that having disclosure unregulated resulted in inconsistency which could be harmful for investors that took interest in sustainability in account for their investments. Concluding with: "I am pleased to support today's proposal because, if adopted, it would provide investors with consistent, comparable, and decision-useful information for making their investment decisions and would provide consistent and clear reporting obligations for issuers"[165] on March 21st, 2022. This was following the new proposal made which would demand from public companies, among other things, audited financial statements containing climate-related information and expenditure metrics, on top of report greenhouse gas emissions and details of how climate change is affecting their businesses. What sums up the stock market is that investors analyze companies based on public information and then, decide what to put their money on. The SEC steps in when there is the need to fix information asymmetries, if public companies fully provide fair and complete disclosure there is no need for intervention[166]. The proposal made would amend regulation S-K to have also the presence of a new section founded on Climate-Related Disclosure which would include a different variety of climate-related information. To avoid repetitiveness, companies have also the chance to avoid inclusion of certain data if already presented in another section of the document. Before describing the framework that was suggested by the proposal, let's take a step back and discuss why the Securities Exchange Commission is so concentrated on ESG. Nowadays more than ever, investors are interested in more than just the material, financial information. They're interested also in how a corporation is impacting their surroundings and environment. Indeed, many companies try to disclose more than what is required by SEC filings, to appear more transparent and reliable to investors. Current and recent commissioners have disclosed different reasons to support this set of disclosure requirement for public companies[167].

[164] *Supra* note 120.

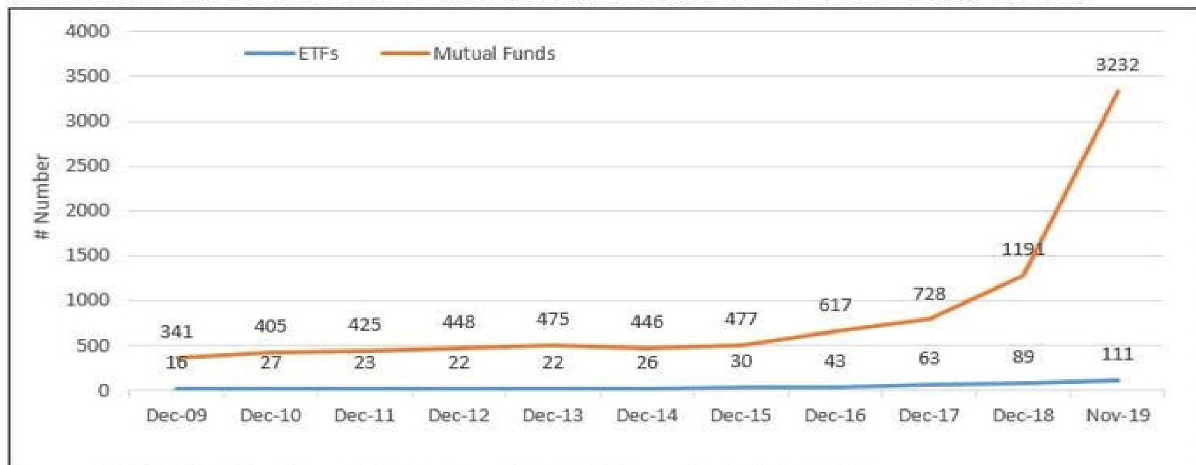
[165] *See* Gary Gensler, *Statement by Chair Gensler on Proposed Mandatory Climate Risk Disclosures*, Harvard Law School Forum (Mar. 21st, 2022), available at https://corpgov.law.harvard.edu/2022/03/21/statement-on-proposed-mandatory-climate-risk-disclosures/

[166] *See* U.S. Security and Exchange Commission, *What We Do,* U.S. Security and Exchange Commission (Nov. 22nd, 2021), available at https://www.sec.gov/about/what-we-do

[167] *See* Jessica B. Magee & Catherine Rowsey, *Navigating the Waters: The SEC's Focus on ESG*, Holland & Knight (Mar. 28th, 2022), available at https://www.hklaw.com/en/insights/publications/2022/03/navigating-the-waters-the-secs-focus-on-esg

According to an article entitled: "ESG Funds Draw SEC Scrutiny"168 which appeared in the Wall Street Journal in 2019, the Security Exchange Commission was commencing to strongly analyze some investment funds that were claiming to be socially responsible and using that concept to market themselves169. The chart below shows how firmly how 'sustainable assets' management in mutual funds and EFTs have expanded from 2009 to 2019. But why is this the case? We have already discussed the general growth of sustainable investing but, more peculiarly: "ESG integration as a strategy has been fueled by research studies that have shown a correlation between sustainability measures in corporations and financial performance, such as improved cash flows, lower cost of capital and higher valuations"170.

**Chart 1: Number of sustainable mutual funds/share classes and ETFs 12/2009- 11/2019**




Sources: STEELE Mutual Fund Expert /Morningstar and Sustainable Research and Analysis LLC

Because of the former extraordinary growth, the Chief of the SEC, Gary Gensler was discussing the fact that he wanted to have something that verified the reliability of funds that were declaring to be working towards those particular goals, denoting themselves as ESG funds to market themselves171. Naturally, Mr. Gensler doesn't have anything against traditional funds, he just demands more clarity and reliability in the information disclosed to investors and most importantly the public. The Case Foundation CEO Jean Case indeed stated: "until we

168 *See* Juliet Chung & Dave Michaels, *ESG Funds Draw SEC Scrutiny*, The Wall Street Journal (Dec, 16th, 2019), available at https://www.wsj.com/articles/esg-funds-draw-sec-scrutiny-11576492201

169 *See* SustainableInvesting, *ESG Funds Draw SEC Scrutiny* (*last visited* May 14th, 2022), available at https://sustainableinvest.com/esg-funds-draw-sec-scrutiny/#:~:text=Introduction%20and%20Summary-,According%20to%20an%20article%20entitled%20%E2%80%9CESG%20Funds%20Draw%20SEC%20Scrutiny,of%20socially%20responsible%20considerations%20or

170 *Id.*

171 *See* Karen Davis, *What Do ESG Funds and Fat-Free Milk Have in Common? Not Enough, According to SEC Chairman Gary Gensler*, Fox Rothschild (June 1st, 2022), available at https://www.foxrothschild.com/publications/what-do-esg-funds-and-fat-free-milk-have-in-common-not-enough-according-to-sec-chairman-gary-gensler

have some consistency and an agreed-upon set of standards, ESG remains a "buyer beware" sector for many investors in spite of the extensive data supporting this investing approach"[172]. This is what is trying to be solved by this framework proposed on March 21st, 2022. The former tries to set a fixed framework, added to the report structure set in SEC filings for decades now, for all public companies. The proposed disclosure requirements in this section would require: Risks, describing how any sort of impact by climate can affect the company's financial statements or business; Impact on the company, defining what impacts by the climate are most likely or have already affected the corporation's strategy, business model and outlook; Risk management/oversight process, reporting the risks that have been identified and how they are going to get assessed and managed (always climate-related), in addition to the risk management process undertaken by the board of directors; GHG Emissions, divided into three scopes for disclosure. Scope 1 disclosing direct greenhouse gas emissions. Scope 2 requires disclosure of indirect emissions from electricity or other types of energy purchased by companies and lastly, Scope 3 describing disclosure of greenhouse gas emissions from activities from the whole company's value chain, upstream and downstream[173]; Ultimately, targets/objectives regarding climate-related goals and plans, if existent[174]. Therefore, since we by now have already seen how relevant sustainability is for some investors, it is arguable that regulating disclosure and imposing this type of requirement in reports isn't a total mistake.

## 2. We Are not The Environmental Commission

The Security Exchange Commission proposal, as we have just said, doesn't have the wrong objective with their framework. However, what was immensely critiqued was the structure of this framework as well as the general theme of climate which, according to some experts, isn't or shouldn't be of their main concern. The former is simply due to the fact that the Congress has delegated the power of managing and supervising the market for investors to the SEC,

[172] *See* Jean Case, *ESG Funds Are Surging. Without Standards, They Remain 'Buyer Beware.',* Barron's (Apr. 29th, 2021), available at https://www.barrons.com/articles/esg-funds-are-surging-without-standards-they-remain-buyer-beware-51619638258

[173] *See* Volker Lainer, *SEC Steps in on ESG Disclosure Rules,* GoldenSource (Mar. 25th, 2022), available at https://www.thegoldensource.com/sec-steps-in-esg-disclosure-rules/#:~:text=On%20March%2021%2C%20the%20SEC,finalized%20later%20on%20in%202022

[174] *See* Gibson Dunn, *Summary of and Considerations Regarding the SEC's Proposed Rules on Climate Change Disclosure,* Gibson Dunn (Apr. 15th, 2022), available at https://www.gibsondunn.com/summary-of-and-considerations-regarding-the-sec-proposed-rules-on-climate-change-disclosure/

hence, sustainability and ESG factors could just not fall into that category. Nevertheless, enforcing this type of disclosure requirement following this proposal would have a great impact on public corporations that still haven't adapted to this sort of data collection/analysis. Hence, this would be a call to action to force them to re-adapt internally to collect and analyze this different data. Is this something to give for granted? On behalf of Mayer Brown, Jaqueline M. Vallette and Kathryne M. Gray had this take on it: "Given the significant additional expense the proposed rules would impose on public companies, the Proposal will likely face legal challenges"175. In addition to the former, what Hester M. Peirce, Commissioner of the Security Exchange Commission had to say was very remarkable as she replied and contradicted the whole proposal. She initially congratulated Chair Gensler for the proposal but followed up discussing that this suggested framework isn't consistent and reliable, unlike the existing regulatory framework176. The commissioner had many points that, if I could give my opinion, appeared very powerful. First, the current system gives the opportunity to investor to see businesses from the eye of their managers which, is the logical way to approach this. On the other hand, the proposal "tells corporate managers how regulators, doing the bidding of an array of non-investor stakeholders, expect them to run their companies"177. Second, there is a package of existing rules which already covers material climate risk. However, it isn't as incisive and direct as the suggestion made which presents a proper bullet-point list of what should matter for corporations. On the contrary, there should be freedom of choice of what managers believe to be material information and therefore should be included in the reports. Naturally this is affected by the type of corporation we are analyzing. Before we have made the example of Verizon, which is a company that has voluntarily adopted this concept in the previous years, however, we haven't really highlighted that it could've been easier for a telecommunication company like Verizon with respect to, as an example, a tobacco producer like Third, the proposal will not lead to consistent and reliable disclosures.

Everyone agrees that the area of communication regarding sustainability and the other factors should be cleared up due to the quantity of confusion and greenwashing. However, this proposal assumes the stability of certain principles which, arguably, just aren't. First, forcing

175 *See* Jacqueline M. Vallette & Kathryne M. Gray, *US SEC's Climate Risk Disclosure Proposal Likely to Face Legal Challenges,* Mayer | Brown (Apr. 21st, 2022), available at https://www.mayerbrown.com/en/perspectives-events/publications/2022/04/us-secs-climate-risk-disclosure-proposal-likely-to-face-legal-challenges#:~:text=On%20March%2021%2C%202022%2C%20the,their%20greenhouse%20gas%20emissions%2C%20and

176 *See* Hester M. Peirce, *We are Not the Securities and Environment Commission - At Least Not Yet,* SEC (Mar. 21st, 2022), available at https://www.sec.gov/news/statement/peirce-climate-disclosure-20220321

177 *Id.*

corporations to quantify their acts towards the ESG factors won't lead the large part of these to release reliable, accurate information to the public. If even a small portion of corporations release faulty information it would lead investors which take these factors in account to take side with a corporation which either, isn't truthful about these actions, or, isn't appropriately collecting information regarding the subject from the inside of their business. If the public becomes aware of the latter, the reflection of it on a stock price would be just drastic.
Secondly, for the report there must be disclosed a link or some sort of description describing the climate impact on the firm's financials. "Disclosures on the physical risk side will require companies to select a climate model and adapt it to assess the effects of climate change on the specific physical locations of their operations, as well as on the locations of their suppliers and customers. This undertaking is enormous"178. The latter indeed will require the intervention of third parties as well as experts who apply their assumption based on models just for the prediction of the climate and its expected impact. The same logic can be applied to tying the climate and how it would affect the strategy of a corporation. Not to mention that the process is facilitated if we are talking about an agricultural firm but for any corporation working in a more theoretical sector it would be relatively than complicated to not leave the field blank.
Fourth, the commission lacks authority to impose this rule in the first place. The SEC has been charged with the task of protecting investors and keeping the markets efficient and in order, without room for information asymmetry. The congress however didn't authorize the Security Exchange Commission to adopt rules that aren't consistent with these matters. Using the disclosure framework to achieve goals which aren't ours to commit to may not comport with the First Amendment limitations on compelled speech. Lastly, as we have anticipated before discussing the commissioner's points, enacting the proposal could be very costly. Corporations shall assure data to insert in a report and if they haven't already adopted ESG in their strategy, the larger the corporation the more costly it will be to do so. Then, the proposal is built on the most common framework which is currently used for voluntary sustainability reporting. However, firstly, these voluntary reports aren't subject to any sort of verification of reliability, especially, when compared to the scrutiny which is applied on SEC filings. Secondly, these are mostly taken into consideration as a guideline but are then adapted to the desires of the managers, so, there isn't a proper popular, standard framework.
To conclude this chapter, the public is worried about the environment for phenomena

[178] *Supra* note 130.

like global warming, should this have effects on the financial system? "It is important to remember, though, that noble intentions, once baked into complex regulatory plans, often have ignoble results. This risk is considerably heightened when the regulatory complexity is designed to push capital allocation toward politically and socially favored ends, and when the regulators designing the framework have no expertise in capital allocation, political and social insight, or the science used to justify these favored ends"[179]. The proposal, if enacted, could hurt investors and their decision making, consequently hurting the stock market and the economy. Commissioner Hester M. Pierce stated indeed: "*We are not the securities and environment commission – at least not yet*[180]*.*

## IV. Is there a short-cut to the finish line?

The real question that comes to mind after the analysis that we have made is, is ESG the answer to the debate of corporate purpose? If the former is the case, is it possible to achieve it quicker with the help of disclosure regulation or do we take the slow path led by market pressure? To
begin to even try to come up with an answer to the second question, we should analyze what the complications of sustainability are but most importantly, how costly it would be to force it upon public, already-established corporations. Let's start off by pointing out that
corporate purpose and ESG are often mistakenly referred to as synonyms. However, these two are very distinct ideas which could be related for some but not all corporations[181]. Inevitably, purpose comes first and then you look for sustainability which could either into it or subtracted from it. Colin Mayer on the matter has defined that the purpose of a company is "to produce profitable solutions to problems of people and planet"[182] while at the same time "not profiting from producing problems for people or planet"[183]. As a matter of fact, looking at the figure down below, we can describe companies with high profitability and low sustainability to be

[179] Id.

[180] *Supra* note 176.

[181] *See* Robert Eccles, Colin Mayer, and Judith Stroehle, *The Difference Between Purpose and Sustainability (aka ESG),* Harvard Law School Forum (Aug. 20th, 2021),available at https://corpgov.law.harvard.edu/2021/08/20/the-difference-between-purpose-and-sustainability-aka-esg/

[182] *Id.*

[183] *Id.*

'socially unsustainable' while a high sustainability, low profitability is a financially unsustainable company. Companies that are instead very profitable and sustainable are hitting the right target in terms of purpose.

| | High Profitability | Low Profitability |
|---|---|---|
| High Sustainability | Purpose Company | Financially unsustainable Company |
| Low Sustainability | Socially unsustainable Company | Walking Dead |

Sustainability is with no doubt the ethical right path and most likely, where the future will inevitably lead us. Nonetheless, as we have said before: "It is important to remember, though, that noble intentions, once baked into complex regulatory plans, often have ignoble results"184. We aren't currently talking about a regulatory plan in this case, but the same concept applies, not all corporations are ready for an imminent demand for ESG factors to be internally incorporated185. The former point is also strengthened by the fact that, up until now, we have been taking into consideration only public companies which, on average, are simply greater in size with respect to the average private company. This argument is based on various points that we are going to call attention to right away. One example is, that the so-called 'triple bottom line'186 is often described as an utopian concept, with the belief that it is an opportunity for corporations since it brings so many positive aspects to the internal and external part of a firm. To make a few examples: employee incentive to be more productive when there is a purpose; Position the company more favorably as the regulation adapts to sustainability; leads to more brand associations due to the more positive reputation; and so on. Unfortunately, most of the time, even if it isn't personally discussed enough, the interest of profit goes in conflict with the idea of the people and the environment or if we'd prefer to give a more optimistic statement, it isn't applicable for every company in any sector187. Indeed, "What would happen to your company's bottom line if it switched over to a green electricity supplier

[184] *Supra* note 176.

[185] *See* Markus Becker, *"If companies do not engage in ESG properly, they will be costed out of business"*, EQS (March 3d, 2022), available at https://www.eqs.com/ir-blog/esg-interview-investor-update/

[186] *Supra* note 72.

[187] *See* Charles Eisenstein, *Let's be honest: real sustainability may not make business sense,* The Guardian (Jan. 8th, 2014), available at https://www.theguardian.com/sustainable-business/blog/sustainability-business-sense-profit-purpose.

at twice the cost?" 188. Evidently, this concept is appropriate when talking about great changes for a corporation, like changing supplier, materials for production and so on. The idealism of going green is often beside some type of payoff like improving your annual financial statement or 'setting a good example' for others (affecting image) almost like they must be tied to some business purpose to push directors in that direction. The rationale for the former could be signified by the fact that the managerial force didn't have an incentive to adopt in their initial strategy, which, would've been a mistake if it delivered better financial performance. I firmly believe that this issue could be fought with government aid, at least up to a certain point, or we shall be patient for technological development. The next point strengthens the one that we just made. Aside from the costly effect that it could have on a corporation's production or to be more general, on the labor side, we could also observe another unfavorable consequence. To have the great impact it deserves, there must be equal effort between producer and consumer. Sustainable suppliers, due to the higher cost of production tend to be forced to raise the prices of the good when sold to the market. To analyze the situation in the simplest manner we should consider both extremes of the equation. In one scenario, the people could all decide that they want to be environmentally friendly and hence, are willing to buy the product just because of the sustainable motif behind it. On the other hand, if everybody goes to the other way around, purchasing from the foreign corporation that is involved in mass production, it could send these producers to bankruptcy or at least bring them to the inevitable discouragement. Therefore, the doubt of this argument is whether sustainable products are seen positively, negatively or neutrally from people189. As we have previously discussed, it is easier to implement sustainability or more generally ESG factors into a corporation before it is large and has many internal connections with the outside world. However, we haven't really considered whether it is easier to achieve financial growth having it implemented in the business' core strategy. On the contrary, it could be harmful as studies have shown that sustainable production leads to goods which are commonly perceived as underperforming on attributes like strength and durability190. The rationale for this matter is that often, individuals follow a theory by which firm resources are 'zero-sum' and by focusing on sustainability, quality is lost in the process. Nevertheless, this argument is opposed by the fact that in general,

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[188] Id.

[189] See Jenny van Doorn & Hans Risselada, *Does sustainability sell? The impact of sustainability claims on the success of national brands' new product introductions,* ScienceDirect (*last visited* May 16th,2022), *available at https://www.sciencedirect.com/science/article/pii/S0148296321005889*

[190] *See* Alexander Chernev & Sean Blair, *Doing Well by Doing Good: The Benevolent Halo of Corporate Social Responsibility,* 1414, (2014).

consumers tend to believe that quality and price are correlated hence, a high price gives the belief that a product is of quality and deserves the price premium[191]. To conclude this point, various interested parties have associated this consumer contribution to the environment as a "purchase of moral satisfaction"[192]. Indeed, surveyed respondents indicated how much personal satisfaction they attributed to helping different causes. It was found that their willingness-to-pay (denoted as WTP) would be higher for causes in which they'd be more interested in[193]. The former are both studies which happened decades ago, however, it could be argued that these ideas are still relevant and applicable to this day. To conclude, let's discuss what we have seen so far to really understand if sustainability is the 'finish line' for this debate and if, we can find a short cut to get there faster. Safia Kazi, supporter of the movement notes: ""If the regulations are more or less similar, companies can adopt enterprise-wide best practices. But if regulations have a lot of variation, it may make sense to arbitrage for various markets ... Unfortunately, shareholders and the general public don't have the leverage needed to make enterprises act ethically"[194]. Stating that it must be the policymakers and the regulators that step up. As a matter of fact, "according to a World Benchmarking Alliance study of 1,000 companies across more than 60 countries. Only 10 of those companies have achieved the fundamental expectations of the United Nations' Sustainable Development Goals, according to the WBA. That's a failure rate of 99% for these powerful companies, which the WBA estimates generate about 25% of the world's gross domestic product and employ more than 56.5 million people"[195]. The results are beneath expectations and no individual can contradict it but, I might argue that a call for regulation would give room to so much uncertainty that it wouldn't be something that could be considered a feasible solution. Especially if it has that big of an impact on 25% of the world's gross domestic product. I personally believe that it would cause uncertainty because a new regulatory system must be implemented in a way that it is standardized and therefore, applies to all listed

[191] *See* Jenny Van Doorn & Peter C. Verhoef, *Willingness to pay for organic products: Differences between virtue and vice foods,* Science Direct (*last visited* May 16th, 2022), *available at https://www.sciencedirect.com/science/article/abs/pii/S0167811611000280*

[192] Daniel Kahneman & Ilana Ritov, *Determinants of Stated Willingness to Pay for Public Goods: A Study in the Headline Method,* 8 Springerlink (1994), https://link.springer.com/article/10.1007/BF01073401.

[193] Leila Hamzaoui-Essoussi & Jonathan Linton, *New or recycled products: How much are consumers willing to pay?*, 460, (2010), https://www.researchgate.net/publication/235283628_New_or_recycled_products_How_much_are_consumers_willing_to_pay.

[194] *See* Bruce Rule, *Companies' broken sustainability promises are escalating calls for regulation and legal action*, Fortune (Mar. 7th, 2022), available at https://fortune.com/2022/03/07/companies-broken-sustainability-promises-are-escalating-calls-for-regulation-and-legal-action/.

[195] *Id.*

companies. At the same time, if it is imposed to corporations it must be something that isn't costly and/or doesn't require any analytical approach because it would cause an immense expenditure if summed across all public companies which haven't already adapted ESG factors into their strategy. Hence, there is no doubt in anyone mind that as time passes sustainability will be more and more present in companies up to a certain point in which the sustainable group will be the majority setting almost a standard or an example. That will be the cause of what market pressure will. Once the world gets to that level, or even before that, there will be room for legislative adaptation to the regulatory disclosure framework. The question therefore is about how and when we get there. To that I answer "next practices change existing paradigms"196. What gives the stimuli for innovation is the incentive given by the demand for a service or concept. This is what exactly brought us where we are today. We have already seen that the desire for a sustainable world by the market and the people in general is having a great influence on the economy. Remarkable events like the proposal of the Security Exchange Commission, even if very criticized, give the message that the group of individuals that sets out regulation is concerned on the matter. Due to these types of happenings, the pressure will keep on growing and it will lead to have an industrial world working for a more sustainable and green process in every sector that influences the outside environment. As we get into this world, all corporations will suddenly feel pushed and incentivized by the number of companies adopting this into their standard procedure. Supporters of this movement are very eager to see this change and it almost seems as they are impatient because of the tension put on them by environmental issues like global warming. All I can say is that I firmly believe that this energy is what the world needs as every company matters, at the same time however, some corporations are in tougher spots than others for this change.

## CONCLUSION

After more than a century, an answer to the question of corporate purpose has still yet to be determined. Shareholderism prevailed since the 1970s even though it was never actually

[196] *See* Ram Nidumolu et al.*, Why Sustainability Is Now the Key Driver of Innovation, Harvard Business Review* (Sep. 2009), available at https://hbr.org/2009/09/why-sustainability-is-now-the-key-driver-of-innovation

affirmed as the final, widely accepted answer for this debate. All up until the early 2000s where sensibility and interest started to show for the other stakeholders as well. In 2010 the remarkable event of introducing the concept of Public Benefit Corporations happened in Maryland, which then went onto spreading all American corporate law. In the last decade, we have seen various happenings which haven't had the influence a stakeholderist would've hoped for but nevertheless, they have shown how relevant this ideal has become. As an example, Larry Fink's letter or the Business Roundtable statement or even the Accountable Capitalism Act. As time has passed, sustainability has gotten very important, up to a point in which, according to some people, it must've been in the back of managers' minds when controlling corporations. Hence, we see the concept of stakeholderism covering a more horizontal spectrum including everything that surrounds firms, from employees to clients and even the environment. Based on the four pillars that we have largely talked about, we can sort of imagine what an impact a final answer will have. Nevertheless, the grand question remains to be: which one of these two theories is correct? Up until now, stakeholder theory has been criticized, making it still not clear if it would be a reasonable conclusion by itself. However, now that ESG is now into the equation, it is looking like a more feasible solution even if, we are still seeking a way of achieving the change. A radical change from one extreme to another would simply not be feasible. Let's analyze why by looking at both extremes. On one extreme, you have shareholder primacy which has been dominating for various decades and would simply be way too complicated to eradicate. Why is that the case? Well, in a theoretical world where stakeholder primacy would be imposed on corporations, it would lead to nothing else but incorporation overseas to operate in America, especially now that technological development has lowered international market barriers even more. On the other side, United States gets to keep shareholder primacy as it is but that, seeing out it recently turned out, would
cause a great and constant pressure from the market onto corporations. Where, most likely, there will be an advantage that grows with time for corporations that instead adopt certain stakeholder metrics. After having done a great amount of research on the topic, even
if I am not yet an expert either on the subject or in any field, I believe that I could give a strong, firm but most importantly feasible opinion on what the solution of the debate could be. Let's begin by saying that I have by now convinced myself that growth towards sustainability and ESG is inevitable. Maybe the former won't cause a radical change in corporate strategy, but corporations will most likely be forced to include it or at least consider it if their background objective is long-run growth. Consequently, I am convinced that the 'finish line' of this debate will be reached when shareholder primacy mixes with ESG for corporate purpose. A question

we have repeated multiple times in last section of this thesis is whether changes in legislation or, to be more specific, disclosure regulation could be used as a short-cut to this theoretical finish line. After analyzing what was proposed by the Security Exchange Commission as well as what was the Commissioner's reply on the topic, I find it to be quite impractical that imposing this new framework for disclosure regulation on top of companies would happen. The former is due simply to the fact that not all corporations are ready yet for this type of change and therefore, it would be a solution which would just be too costly for single corporations but most importantly for United States' GNP. Nevertheless, we cannot ignore that the proposal itself has showed a very strong message to the market but most importantly, listed corporations. To me, it almost looked like a heads up on the fact that there is going to be some change in five to ten years to the disclosure regulation framework which has now been the same for decades. As a matter of fact, it was also discussed by critics that in the letter that Commissioner Hester M. Pierce used to reply to the proposal, she was protecting the current framework, but at the same time, "she actually opposes many important and established elements of the very framework she says she wants to conserve"[197]. Hence, can regulation be a shortcut to the finish line? I might argue that it can be, however not under the shape of disclosure regulation and not under act of the Securities Exchange Commission but of the Government. I see the main threat of sustainability being international competition. To give an example, if all domestic suppliers of a theoretical product decide to put sustainability into their priorities because the market is applying a lot of pressure upon them, they will most likely be forced to raise prices of his good due to the cost of the change in material or procedure which makes them environmental-friendly. At this point, it would be up to the consumers to decide how successful the ESG suppliers will be. Nowadays, it is very likely that there will be a substitute for that good which is imported from an overseas mass producer at a much lower price. Therefore, how do we help the supporters of the environment in these cases? To conclude with my modest opinion, the government could place some sort of per-unit or lump sum tariff upon importers of not environmentally friendly goods. This will lead to an inevitable raise in prices of the business dealers which import to sell domestically, therefore lowering the gap in cost between sustainable and unsustainable goods. On the top of it, the government is earning a revenue which could be used for the same reason by subsidizing other corporations that are making an effort to make this shift to ESG.

[197] *See* Joanheminway, *The SEC's Climate Disclosure Proposal: Critiquing the Critics*, Business Law Prof Blog (March 27th, 2022), available at https://lawprofessors.typepad.com/business_law/2022/03/the-secs-climate-disclosure-proposal-critiquing-the-critics.html.

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