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Corporate Governance in Crisis Times

Since the apex of the economic crisis last year, American companies have been buried in an avalanche of corporate governance initiatives designed to increase the power of fund managers to dictate corporate policies to boards of directors. Unfortunately, few, if any, of the proposals focus on what must be the overriding objective of corporate governance—encouraging long-term economic growth: the type of growth that is achieved without risking the environment or the financial system; the type of growth that creates and maintains full employment; the type of growth that creates affordable housing, healthcare and education for all.

The evidence is irrefutable that the pressure for short-term performance and quick stock market profits were prime factors in causing the economic crisis. Indeed, President Obama has said that compensation practices tied to short-term performance were responsible for “a reckless culture and a quarter-by-quarter mentality that in turn wrought havoc in our financial system.”

It is critical that we recognize that short-termism encourages excessive risk and diversion from the long-term planning essential to sustainable economic growth and that we use this insight to critically evaluate the entire range of corporate governance initiatives that are now on the table. There is no reason to embrace a plethora of ill-conceived federal regulation and legislation that usurps the traditional role of state law and thereby overturn the fundamental legal doctrines that have formed the bedrock of history’s most successful economic system. The engine of true economic growth will always be the informed business judgment of directors and managers, and not the hunger of short-term oriented shareholders for quick profits.

Particularly at a time of depressed stock market valuations and the resulting danger of opportunistic attacks to bust up or takeover American companies, directors and managers must remain free to invest in the future and take the long-term view, so as to ensure prosperity for future generations. To the same extent that we need to avoid legislative and regulatory actions that would undermine the ability of companies to achieve long-term growth, the courts should continue to recognize the prerogative of directors to plan for and achieve long-term value for the company and its stockholders, protected against short-termist pressure from any source and especially from the unintended consequence of proposed “reforms” (such as shareholder proxy access) that are not appropriately defined and contained. In particular, the right of a well-informed board of directors to “Just Say No” to a takeover bid remains a critical deterrent to short-termism. Under the Business Judgment Rule, directors must remain unfettered in their ability to engage in long-term planning and investment.

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