

Some Thoughts for Boards of Directors in 2019

(Including The New Paradigm: A Roadmap for
an Implicit Corporate Governance Partnership
Between Corporations and Investors to Achieve
Sustainable Long-Term Investment and Growth)

Martin Lipton, Steven A. Rosenblum, Karessa L. Cain,
Amanda S. Blackett and Kathleen C. Iannone

December 14, 2018

This memorandum may be accessed online at:
<http://www.wlrk.com/webdocs/wlrknew/WLRKMemos/WLRK/WLRK.26288.18.pdf>

*If your address changes or if you do not wish to continue receiving these memos,
please send an e-mail to Publications@wlrk.com or call 212-403-1443.*

Some Thoughts for Boards of Directors in 2019

In recent years, it has become increasingly evident that the activism-driven corporate world is relatively fragile and is proving to be unsustainable, particularly when viewed in the broader context of rapidly changing political and social norms and increasing divisiveness across many planes of the social contract. The exponential widening of income inequality, the increasing sense of urgency around climate change, and the widespread socioeconomic upheaval resulting from the displacement of human capital by technology have all been filtering into the debate about the role and governance of the corporate ecosystem. Persuasive academic and empirical evidence has established the causal link between short-termism and widespread harms to GDP, national productivity and competitiveness, innovation, wages and employment. In addition, the concepts of sustainability, ESG (environment, social and governance) and “corporate purpose” have all been gaining traction in the corporate governance lexicon.

There is now a growing recognition in the investment community that expectations of shareholders and other stakeholders should extend beyond the financial bottom line, and that the sustainability and credibility of a corporation’s long-term strategy cannot be assessed without taking into account the interdependencies between a corporation and its employees, customers, communities, the environment and other stakeholders. This represents a clear pivot away from Milton Friedman’s 1960s ex cathedra doctrinal pronouncement that “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

or fraud.” An example of this new mindset is the statement by Larry Fink (CEO of BlackRock) in his January 2018 [letter](#) to CEOs of major corporations:

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.

Without a sense of purpose, no company, either public or private, can achieve its full potential. It will ultimately lose the license to operate from key stakeholders. It will succumb to short-term pressures to distribute earnings, and, in the process, sacrifice investments in employee development, innovation, and capital expenditures that are necessary for long-term growth. It will remain exposed to activist campaigns that articulate a clearer goal, even if that goal serves only the shortest and narrowest of objectives. And ultimately, that company will provide subpar returns to the investors who depend on it to finance their retirement, home purchases, or higher education.

With respect to activism, major institutional investors have been increasingly skeptical and cautious of being lumped into the same category as activist hedge funds. A notable development in this regard was T. Rowe Price’s announcement in June 2018 expressing its policy views and investment philosophy on shareholder activism from the perspective of a mutual fund family dedicated to active, rather than passive, investment management. In its memo, [Investment Philosophy on Shareholder Activism](#), T. Rowe Price stated that it will apply a multiyear view when making decisions in activist campaigns, rather than pursuing short-term returns. Furthermore, it will not seek to instigate activist campaigns against a portfolio company by “pitching” targets to activist investors, nor will it let an activist speak for T. Rowe Price. Instead, it vowed to work with companies and

provide candid feedback directly to management and activist investors alike, so that both parties in an activist campaign know where it stands. In addition, its portfolio managers will make their own voting decisions, rather than just following the recommendations of proxy advisors on proxy contests.

On the legislative front, the [Accountable Capitalism Act](#), a bill that would make all corporations with \$1 billion or more of annual revenue subject to a federal corporate governance regime (by requiring them to be chartered as a United States corporation), was introduced this past August by Senator Elizabeth Warren. Among other things, this regime would mandate that not less than 40% of the directors of a United States corporation must be elected by employees, and that directors must consider the interests of all corporate stakeholders—including employees, customers, suppliers, investors and the communities in which the corporation operates. Although the passage of such a bill in the United States currently seems highly unlikely, its introduction serves as a warning that legislative solutions could be imposed over time if the issues of sustainability and stakeholder interests are not adequately addressed by the private sector. In Europe, the British government agreed to amend the law to make it clear that pension plans have a fiduciary duty to protect long-term value by considering environmental risks of the companies in which they invest.

In addition, the British Academy has undertaken a study to create a framework for “[The Future of the Corporation](#).” The project is led by Oxford Professor Colin Mayer, who presents a radical reinterpretation of the nature of the corporation that focuses on the corporate purpose, its alignment with social purpose, the trustworthiness of companies and the role of corporate culture in promoting purpose and trust. This view of the corporation rejects shareholder primacy as the corporation’s sole goal. “Corporate purpose is distinct from the consequential

implications for the corporation's profitability and shareholder returns. The purpose of corporations is not to produce profits. The purpose of corporations is to produce profitable solutions for the problems of people and planet. In the process, it produces profits, but profits are not per se the purpose of corporations." This view of the corporation of the future would be implemented by establishing a regulatory system that would promote an alignment of corporate conduct with social purposes and ensure that companies' ownership, governance, measurement and incentive systems are appropriate for these purposes. Professor Mayer's views are more fully reflected in Prosperity: Better Business Makes the Greater Good (Oxford University Press 2018).

These and other developments suggest that legislative and regulatory reforms are a distinct possibility, and that meaningful change is inevitable through one means or another. That prospect makes the case for devising and implementing a private-sector solution all the more pressing.

A number of initiatives have been underway to establish a modern corporate governance framework that is calibrated to the current environment. For our part, at the request of the World Economic Forum, we prepared a paper titled, [The New Paradigm: A Roadmap for an Implicit Corporate Governance Partnership Between Corporations and Investors to Achieve Sustainable Long-Term Investment and Growth](#), which was issued in September 2016. As part of that project, we sought to create a foundation for broad-based consensus and, accordingly, in the drafting stage, we tested *The New Paradigm* with a sizable number of major corporations and incorporated the feedback we received. In essence, *The New Paradigm* conceives of corporate governance as a collaboration among corporations, shareholders and other stakeholders working together to achieve long-term value and resist short-termism. It provides a roadmap for boards to demonstrate that they are providing

thoughtful, engaged oversight and that management is diligently pursuing credible, long-term business strategies. In addition, *The New Paradigm* is attuned to the significant influence and role of asset managers and institutional investors, and urges them to embrace stewardship principles and provide the support and patience needed for companies to pursue long-term investments. It posits that, while there may sometimes be differences of opinion and changes may be warranted, corporations and shareholders are almost always better served by working together on a collaborative basis than by doing battle or allowing an activist to interpose itself.

Since the time that we initially proposed *The New Paradigm*, a number of developments have prompted us to reassess and revise this framework, with a view to further tailoring it as a middle-of-the-road approach and enhancing its usefulness as a private-sector solution to combat short-termism, while hopefully warding off a new round of politically driven and potentially misdirected governmental intervention. The following summary is an updated synthesis of the principles outlined in *The New Paradigm*, which we have prepared outside the auspices of the World Economic Forum with a view to making updates based on prevailing institutional investor policies and public statements. In addition, we are mindful of the ever-expanding assortment of corporate governance frameworks, codes and principles for boards and investors to consider, and have accordingly sought to integrate these frameworks with a view to offering *The New Paradigm* as a comprehensive roadmap that could be adopted by all of the proponents of governance and stewardship guidelines. To this end, we have borrowed from several of the recently promulgated sets of principles.

No legislation or regulation is necessary to implement *The New Paradigm*. Companies, asset managers and institutional investors can unilaterally announce their adoption of and adherence to the principles of *The New Paradigm*.

Consistent with observations made by Chief Justice Strine in his article, [*Who Bleeds When the Wolf Bites?: A Flesh-and-Blood Perspective on Hedge Fund Activism and Our Strange Corporate Governance System*](#), from both a corporate law and a trust law standpoint, the following principles are intended to achieve long-term growth in value while eschewing actions and policies which threaten future growth and value, or the franchise itself. Adoption of and adherence to the principles of *The New Paradigm* is consistent with the fiduciary duties of companies and boards of directors to shareholders, and of asset managers to institutional investors and the underlying beneficiaries for whom they are acting.

* * *

The New Paradigm

The New Paradigm: A Roadmap for an Implicit Corporate Governance Partnership Between Corporations and Investors to Achieve Sustainable Long-Term Investment and Growth rejects shareholder primacy and is instead premised on the idea that stakeholder governance and ESG are in the best interests of shareholders. While it recognizes a pivotal role for boards of directors in harmonizing the interests of shareholders and other stakeholders, it also assumes that shareholders and other stakeholders have more shared objectives than differences—namely, they have the same basic interest in facilitating sustainable, long-term value creation. In this framework, the board of directors can exercise business judgment to implement the company’s objectives, and the company and its shareholders engage on a regular basis to achieve mutual understanding and agreement as to corporate purpose, societal purpose and performance. Ultimately, the shareholders’ power to elect the directors determines how any conflicts are resolved, if they are not resolved by engagement. However, since the company and its shareholders have the same fundamental objectives, there should be little room for activism and short-termism.

The New Paradigm is premised on the idea that companies and shareholders can forge a meaningful and successful private-sector solution to attacks by short-term financial activists and the short-termism that significantly impedes long-term economic prosperity. 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.

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.

In this framework, if a company, its board of directors and its CEO and management team are diligently pursuing well-conceived strategies that were developed with the participation of independent, competent and engaged directors, and its operations are in the hands of competent executives, asset managers and investors will support the company and refuse to support short-term financial activists seeking to force short-term value enhancements without regard to long-term value implications.

Companies, asset managers and institutional investors that embrace *The New Paradigm* should endorse the efforts of the [Investor Stewardship Group](#), [Focusing Capital on the Long Term Global](#), the [Coalition for Inclusive Capitalism](#) and similar organizations, to promote governance, stewardship and engagement principles consistent with *The New Paradigm*.

Governance

Purpose and Strategy. The board of directors and senior management should jointly articulate the company's purpose and oversee its long-term strategy, ensuring that the company pursues sustainable long-term value creation.

- The board of directors should oversee the company's business strategies to achieve long-term value creation, including by having meaningful input over the company's capital allocation process and strategy.
- The board should help the company articulate its purpose and the ways in which it aims to make a positive contribution to society, recognizing that there are various stakeholders including employees, customers, communities and the economy and society as a whole.

- The board of directors should go beyond a “review and concur” role to ensure that it understands the strategic assumptions, uncertainties, judgments and alternatives that underpin the company’s long-term strategy.

***Management and Oversight.* The board of directors is responsible for overseeing the management of the company, monitoring company performance and preparing for senior management succession.**

- The board of directors sets the “tone at the top” to cultivate an ethical culture and demonstrate the company’s commitment to integrity and legal compliance. In setting the right tone, transparency, consistency and communication are key—the board’s vision for the company should be communicated effectively throughout the organization and to the investing public. Companies should have in place mechanisms for employees to seek guidance and alert management and the board of directors about potential or actual misconduct without fear of retribution.
- The board of directors should periodically review the company’s bylaws, governance guidelines and committee charters and tailor them to promote effective board functioning. The board of directors should be aware of the governance expectations of shareholders who hold a meaningful stake in the company, and should take those expectations into account in periodic reviews of the company’s governance principles. Boards of directors of companies that currently have dual or multiple class share structures should review these structures on a regular basis and, where warranted, establish mechanisms to end or phase out non-economic controlling structures at the appropriate time, taking into account the stage of the company’s development and all other relevant factors.
- The board of directors has two key roles with respect to management: oversight of management and partnership with management. The board of directors should work to foster open, ongoing dialogue between members of the board and management. This dialogue requires directors to have access to senior management outside of board meetings. Management has an obligation to provide information to directors, and directors should seek clarification and amplification where necessary. Deep understanding of a company’s business cannot be gained or maintained solely in board meetings. At the core, every director should understand how the company makes a profit and fulfills its purpose, and the threats and opportunities it faces.

- The board of directors and senior management should jointly determine the company's reasonable risk appetite, oversee implementation of standards for managing risk and foster a culture of risk-aware decision-making. In fulfilling its risk management function, the board's role is one of informed oversight rather than direct management of risk. The board of directors should consider significant risks to the company, including technological disruption, cybersecurity and reputational risks. The board should not be reflexively risk averse; the board should seek appropriate calibration of risk to benefit the long-term interests of the company.
- Even with effective risk management, crises will emerge and test the board of directors, with potential situations ranging from the unexpected departure of the CEO to risk management failures and major disasters. Each crisis is different, but in most instances when a crisis arises, directors are best advised to manage through it as a collegial body, working in unison with the CEO and senior management team (unless the crisis relates directly to the CEO and/or management team). Once a crisis starts to unfold, the board of directors needs to be proactive and provide careful guidance and leadership in steering the company through the crisis. If there is credible evidence of a violation of law or corporate policy, the allegation should be investigated and appropriate responsive actions should be taken. The board of directors, however, should be mindful not to overreact, including by reflexively displacing management or ceding control to outside lawyers, accountants and other outside consultants.
- The board of directors should maintain a close, truly collegial relationship with the CEO and senior management that facilitates frank and vigorous discussion and enhances the board's role as strategic partner and evaluator. The board of directors should monitor the performance of the CEO and senior management.
- The board of directors and senior management should maintain a succession plan for the CEO and other key members of management, and oversee the cultivation of a pipeline that develops candidates with the requisite skills, expertise, diversity of backgrounds and perspectives, and other considerations. The board of directors should prioritize succession planning by addressing it on a regular rather than reactive basis, including having an emergency plan in the event of an unexpected CEO departure or disability. Direct exposure to employees is critical to the evaluation of the company's senior management. This is especially important in the current environment

in which it is typical for the CEO to be the only management person with a seat at the board table.

- Companies should frame required quarterly reporting in the broader context of their long-term strategy and use quarterly reporting to address progress toward long-term plans. Companies should not feel obligated to provide earnings guidance.
- The board of directors should carefully consider extraordinary transactions and receive the information and take the time necessary to make an informed and reasoned decision. The board of directors should take center stage in a transaction that creates a real or perceived conflict of interest between shareholders and management, including activist situations. It may be desirable for the board of directors to retain experienced outside advisors to assist with major transactions, particularly where there are complicated financial, legal, integration, culture or other issues or where it is useful for the board of directors to obtain independent objective outside guidance. However, the board should be careful not to create unnecessary divisions through the use of special committees with their own separate advisors when there is no legal requirement for a special committee.

***Quality and Composition of Board of Directors.* Directors should have integrity, competence and collegiality, devote the significant time and attention necessary to fulfill their duties and represent the interests of shareholders and other stakeholders. The board of directors as a whole should include diverse backgrounds, experiences and expertise that are tailored to the company's needs.**

- Every director should have integrity, strong character, sound judgment, an objective mind, collegiality, competence and the ability to represent the interests of shareholders and other stakeholders. After competency and integrity, the next most important (yet often underemphasized) consideration is collegiality.
- When filling vacancies, directors should take a long-term strategic view focused not merely on filling immediate vacancies on an ad hoc basis, but on constructing a well-rounded board that works well together and is bonded together by mutual trust and respect. The quality of team dynamics may have a significantly greater impact on firm performance than the sum of individual director contributions.

- The composition of a board should reflect a complementary diversity of thought, background, skills, experiences and tenures. The board of directors should develop a system for identifying diverse candidates, including women and minority candidates, and for effectively integrating new members into the board dynamic.
- A substantial majority of the board of directors should be independent. The board of directors should consider all relevant facts and circumstances when evaluating independence. Long-standing board service should not, by itself, disqualify a director from being considered independent.
- The board of directors should have an independent board leader. The board of directors should decide, based on the circumstances, whether to have separate or combined chair and CEO roles. The board of directors should explain its decision to shareholders, and, if the roles are combined, should appoint a strong lead independent director. The lead independent director should serve as a liaison between the chairman of the board and the independent directors, preside over executive sessions, call meetings of the independent directors when necessary, guide the board's self-assessment or evaluation process, and guide consideration of CEO and senior management compensation and succession.
- The size of the board of directors will depend on the nature, size and complexity of the company and its state of development. In general, the board of directors should be large enough to include a diversity of perspectives and as small as practicable to promote open dialogue.
- Companies should consider limitations on the number of other boards of directors on which a director sits to ensure a director's ability to dedicate sufficient time to the increasingly complex and time-consuming matters that the board of directors and committees are expected to oversee.
- The composition of a board of directors should reflect a range of tenures. The board of directors should consider whether policies such as a mandatory retirement age or term limits are appropriate, but board refreshment should be tempered with the understanding that age and experience can bring wisdom, judgment and knowledge. Substantive director evaluation and re-nomination decisions will serve better than arbitrary policies.
- Directors should spend the time needed and meet as frequently as necessary to discharge their responsibilities and should endeavor to attend all board and

committee meetings, as well as the annual meeting of shareholders. The full board of directors should have input into the board agenda.

- Time for an executive session without the CEO or other members of management should be on the agenda for each regular board meeting.
- Confidentiality is essential for an effective board process and for the protection of the company, and director confidentiality is not inconsistent with engagement pursuant to *The New Paradigm*. Directors should respect the confidentiality of all discussions that take place in the boardroom. Moreover, directors generally owe a broad legal duty of confidentiality to the company with respect to information they learn about the company in the course of their duties.
- The board of directors should have a well-developed committee structure with clearly understood responsibilities. Decisions about committee membership should be made by the full board based on recommendations from the nominating and governance committee. Committees should meet all applicable independence and other requirements. Committees should keep the full board of directors and management apprised of significant actions.
- Companies should conduct a robust orientation for new directors and all directors should be continually educated on the company and its industry. New board members should receive extensive education about the company's business, purpose and strategy. That process should include sessions with the CEO, other directors, members of senior management and, in appropriate cases, major shareholders.
- Companies may find it useful to have an annual two- to three-day board retreat with senior executives to conduct a full review of strategy and long-range plans. Companies should also provide directors with regular tutorials and site visits as part of expanded director education, and external experts, such as independent counsel or other consultants, in appropriate circumstances to assure that in overseeing complicated, multi-industry and new-technology businesses and strategies, the directors have the information and expertise they need. Companies and boards may also find it useful for directors to have access to the workforce.
- The board of directors and CEO should together determine the information the board should receive and periodically reassess the board's information

needs. The key is to provide useful and timely information without overloading the board.

- The board of directors should evaluate the performance of individual directors, the full board of directors and board committees on a continuing basis. Evaluations should be substantive exercises. Evaluations should be led by the non-executive chair, lead independent director or appropriate committee chair, and externally facilitated evaluations may be appropriate from time to time.
- In an uncontested election, directors should be elected by a majority of the votes cast “for” and “against/withhold” (abstentions and non-votes should not be counted) for terms consistent with long-term value creation. Boards of directors should adopt a resignation policy under which a director who does not receive a majority vote in an uncontested election should tender his or her resignation for consideration by the board of directors.
- Investors who own a meaningful stake in the company and have owned such stake for a sufficient period of time should have a meaningful opportunity to recommend director candidates for nomination by the nominating and governance committee to appear on the management ballot.

***Compensation.* Executive and director compensation should be designed to align with the long-term strategy of the company and incentivize the generation of long-term value, while dis-incentivizing the pursuit of short-term results at the expense of long-term results.**

- The board of directors should develop management compensation structures that are aligned with the long-term strategy and risk compliance policies of the company. The board of directors should carefully consider whether management compensation structures promote risk-taking that is not consistent with the company’s overall risk appetite. A change in the company’s long-term strategy or risk compliance policies should trigger a re-evaluation of management compensation structures.
- Executive compensation should have a current component and a long-term component. A substantial portion should be in the form of stock or other equity, with a vesting schedule designed to ensure economic alignment with investors. In general, executives should be required to hold a meaningful amount of company stock during their tenure and beyond.

- The board of directors or its compensation committee should understand the costs of compensation packages and the maximum amount payable in different scenarios. In setting executive compensation, the compensation committee should take into account the position of the company relative to other companies, but use such comparison with caution, in view of the risk of an upward ratchet in compensation with no corresponding improvement in performance.
- In considering executive compensation, companies should be sensitive to the pay and employment conditions elsewhere in the company and take into account the pay ratios within the company. The board of directors should also consider the views of shareholders, including as expressed in “say-on-pay” votes, but should not abdicate its role in deciding what is best for the company.
- Companies should monitor, restrict or prohibit executives’ ability to hedge the company’s stock and oversee the adoption of policies to mitigate risks, such as compensation recoupment or clawbacks.
- Directors should receive compensation that fairly reflects the time commitment and exposure to public scrutiny and potential liability of public company board service, with appropriate benchmarking against peer companies. Independent directors should be equally compensated, although lead independent directors and committee chairs may receive additional compensation and committee fees.
- If directors receive additional compensation from the company not related to service as a director, such compensation should be disclosed and explained to the entire board and to shareholders.

***Corporate Citizenship.* Consideration should be given to the company’s purpose and its stakeholders—including shareholders as well as employees, customers, suppliers, creditors and the community in which the company does business—in a manner that contributes to long-term sustainability and value creation.**

- Companies should be good citizens of the communities in which they do business and produce value and solutions for stakeholders, with consideration of relevant sustainability and societal issues in operating their businesses. Good stakeholder relationships are good business and are good for business.
- Companies should identify and articulate their purposes—i.e., their objectives and contributions to societal and public interests. Profits are not the raison

d'être of a company, but rather are a product of its pursuit of its corporate purposes.

- The board of directors and senior management should integrate relevant ESG matters into the company's strategic and operational planning, budgeting, resource allocation and compensation structures. The company should communicate its policies on these subjects to shareholders.
- Companies have an important perspective to contribute to public policy dialogue on issues related to the company's business or purpose. If a company engages in political activities, the board of directors should oversee such activities and consider whether to adopt a policy of disclosure of the activities.

Engagement

***By the Company.* The board of directors and senior management should engage with major shareholders on issues and concerns that affect the company's long-term value and be responsive to those issues and concerns.**

- Companies should disclose their adoption of and adherence to *The New Paradigm*.
- The board of directors and senior management should establish communication channels with investors and be open to dialogue. Boards should be responsive to asset managers and investors and be proactive in order to understand their perspectives.
- Companies should clearly articulate for asset managers and investors the company's vision, purpose and strategy, including key drivers of performance, risk and evolution of the business model. The company should explicitly describe how the board of directors in particular has actively reviewed long-term plans and that it is committed to doing so regularly.
- Companies should explain and make the financial case for long-term investments, including capital projects, investments in equipment and technology, employee education, workforce training, out-of-the-ordinary increases in wages and benefits, research and development, innovation and other significant initiatives.
- Companies should make adequate disclosures on a variety of topics, including: how compensation practices encourage long-term growth; the director recruitment and refreshment process; succession planning;

consideration of relevant sustainability, citizenship and ESG matters; climate risks; political risks; corporate governance and board practices; anti-takeover measures; material mergers and acquisitions; and major capital commitments and capital allocation priorities. Companies should explain the bases for their recommendations on the matters that are submitted to a shareholder vote.

- Companies should disclose their approach to human capital management, including employee development, diversity and a commitment to equal employment and advancement opportunity, health and safety, labor relations and supply chain labor standards.

By Shareholders. Asset managers and investors should be proactive in engaging in dialogue with a company as part of a long-term relationship and should communicate their preferences and expectations.

- Asset managers and investors should disclose their adoption of and adherence to *The New Paradigm*.
- Asset managers and investors should actively listen to companies, participate in meetings or other bilateral communications and communicate their preferences, expectations and policies with respect to engaging with and evaluating companies.
- Asset managers and investors should accept their responsibility to understand the purpose and strategy of companies in which they invest, and to eschew ideological positions not tailored to each company's position and needs.
- Asset managers and investors should clearly state their expectations for a company and provide candid and constructive feedback.
- Asset managers and investors should address and attempt to resolve differences with a company promptly by first engaging privately in a constructive and pragmatic manner that is intended to build trust and a common understanding, and should give due consideration to the company's rationale.
- Asset managers and investors should acknowledge their role in supporting the long-term interest of the company and its stakeholders as a whole, provide companies with candid and direct feedback and give companies prompt notice of any concerns. To the extent that an asset manager's or investor's

expectations for any given company evolve over time, the asset manager or investor should proactively communicate those changes to the company.

- Asset managers and investors should invite companies to privately engage and should work collaboratively with boards of directors and management teams to correct subpar strategies and operations, but this does not mean that the asset manager or investor needs to abandon its support for companies in resisting the short-termism advocated by activists. Asset managers and investors should make clear that activists do not speak for them. Asset managers and investors should provide an opportunity for a company to engage privately on an issue or concern before publicly disclosing a negative opinion about the company.
- Asset managers and investors should disclose to the companies in which they invest their preferred procedures and contacts for engagement and establish (and disclose) clear guidelines regarding what further actions they may take in the event they are dissatisfied with the outcome of their engagement efforts. Those procedures and policies may differ on a company-by-company basis depending on the relative stakes involved and the shareholders' views about the value of differing levels of engagement with particular companies.

***Shareholder Proposals and Votes.* Boards of directors should consider shareholder proposals and key shareholder concerns, but asset managers and investors should seek to engage privately before submitting a shareholder proposal.**

- Boards of directors should respond to shareholder proposals that receive significant support by implementing the proposed change if the board of directors believes it will improve governance, or by engaging with shareholders and providing an explanation as to why the change is not in the best long-term interest of the company if the board of directors believes it will not be constructive.
- Investors should raise critical issues to companies as early as possible in a constructive and proactive way, and seek to engage in a dialogue before submitting a shareholder proposal. Public battles and proxy contests have real costs and should be viewed as a last resort where constructive engagement has failed.

- Long-term asset managers and investors should recommend potential director candidates if they know the individuals well and believe they would be additive to the board.
- Shareholders have the right to elect representatives and receive information material to investment and voting decisions. Indeed, it is an essential element of correcting shareholder-corporate relationships that key shareholders be informed on a company-specific basis and accept the responsibility that comes with their role in *The New Paradigm*. It is reasonable for shareholders to oppose re-election of directors who have persistently failed to respond to their feedback after efforts to engage constructively.
- Boards of directors should communicate drivers of management incentive awards and demonstrate the link to long-term strategy and sustainable economic value creation. If the company clearly explains its rationale regarding compensation plans, asset managers and investors should give the company latitude in connection with individual compensation decisions. As noted, the board of directors should take into account “say-on-pay” votes.

***Interaction and Access.* Companies, asset managers, shareholders and other key stakeholders should provide each other with the access necessary to cultivate engagement and long-term relationships.**

- Engagement through disclosure is often the most practical means of engagement, though in other cases, in-person meetings or interactive communications may be more effective. Opportunities to engage with shareholders include periodic letters—both from management to articulate management’s vision and plans for the future, and from the board of directors to convey board-level priorities and involvement—as well as investor days, proxy statements, annual reports, other filings and the company’s online presence.
- Independent directors should be available to engage in dialogue with major investors and asset managers in appropriate circumstances.
- The ultimate decision-makers of the company’s key stakeholders—including investors and asset managers with significant holdings and unions, labor or other employee groups—should have access to the company, its management and, in some cases, members of its board of directors, and likewise the company should have access to stakeholders’ ultimate decision-makers.

- Boards of directors and senior management should cultivate relationships with the government, the community and other stakeholders.
- Companies, asset managers and investors should cooperate to develop metrics to measure the value of ESG and sustainable investments, such as those advanced by the Embankment Project of the Coalition for Inclusive Capitalism.

Stewardship

***Beneficial Owners.* Asset managers are accountable to their investors—the beneficial owners whose money they invest—and they should use their power as shareholders to foster sustainable, long-term value creation for their investors and for the companies in which they invest.**

- Asset managers and investors should provide steadfast support for the pursuit of reasonable strategies for long-term growth and speak out against conflicting short-term demands. An asset manager’s support should be expressed through constructive engagement, public expressions of support and voting in favor of management proposals. The support of institutional investors, and the vocal endorsement from respected and influential asset managers to act as a “champion” for a company, can be decisive in curbing short-termist pressure.
- Asset managers and investors who have policies supporting ESG and sustainable long-term investment strategies should not invest in activist hedge funds whose tactics promote short-termism.
- Asset managers should establish a firm-wide culture of long-term thinking and patient capital that persists through cycles of short-term turbulence, including through the design of employee compensation to discourage the sacrifice of long-term value for short-term gains.
- Asset managers should adopt, disclose and follow guidelines and practices that help them oversee the corporate governance practices of a company. Disclosure should include the asset managers’ long-term investment policies, evaluation metrics, governance procedures, views on quarterly reports and earnings guidance, and guidelines for relations with or policies towards short-term activists. Asset managers should also disclose whether they use consultants to evaluate strategy, performance and transactions and how a company can engage with those consultants. Asset managers and institutional

investors should disclose their acceptance of and adherence to *The New Paradigm*.

- Asset managers should evaluate the performance of boards of directors, including director knowledge of governance and other key investor concerns, as well as the board of directors' focus on and understanding of the company's long-term strategic plan. That evaluation may be shared with the board of directors through the lead independent director or independent chair, with candid feedback expected in return.

***Voting.* Asset managers should actively vote on an informed basis consistent with the long-term interests of their investors, which aligns with the long-term success of the companies in which they invest.**

- Asset managers should devote sufficient time and resources to the evaluation of matters for shareholder voting in the context of long-term value creation. Asset managers should consider increasing their in-house staffing and capabilities to the extent appropriate in order to dedicate sufficient time and attention to understanding a company's business plan and long-term strategy, getting to know its management and engaging effectively with the companies in which they invest.
- Asset managers and investors should not abdicate decision-making to proxy advisory firms; rather, asset manager votes should be based on the independent application of internal policies and guidelines, and the assessment of individual companies and their boards and management. Asset managers may rely on a variety of information sources to support their evaluation. Third-party analyses and recommendations, including those of proxy advisory firms, should assist but not be a substitute for individualized decision-making that considers the facts and circumstances of each company.
- Asset managers should disclose their proxy voting and engagement guidelines and report periodically on stewardship and voting activities.
- Asset managers and investors who have announced their adoption of and adherence to *The New Paradigm* or who have policies supporting ESG and sustainable long-term investment strategies should explain any vote in favor of a proposal by an activist hedge fund that is opposed by the company.

- Asset managers should have clear procedures that help identify and manage potential conflicts of interest in their proxy voting and engagement and disclose such procedures.

***Investor Citizenship.* Asset managers and investors should consider value-relevant sustainability, citizenship and ESG factors when developing investment strategies.**

- Asset managers and investors should consider the ways in which ESG factors are relevant to sustainable growth, and integrate such factors into their investment analysis and investment decisions.
- Asset managers should disclose their positions on social and societal purpose and on other ESG matters.

Conclusion

As we began, we conclude with our recommendation that *The New Paradigm* should be embraced and implemented by companies, asset managers and investors. To this end, we endorse Professor Mayer's view of corporate purpose:

The importance of corporate purpose derives from the fact that it is the basis on which relations of trust are created in business. When corporations commit to a purpose, they commit to the various parties that are involved in the delivery of it and, in return, the parties to the firm commit to the attainment of the corporate purpose. This creates reciprocal benefits for the firm, its stakeholders and society at large. It promotes more loyal customers, more engaged employees, more reliable suppliers, more supportive communities and more participative investors. In other words it raises revenue and lowers costs, thereby benefitting firms as well as their associated parties.

Key Sources

- [Accountable Capitalism Act, August 15, 2018](#)
- [Activism: The State of Play, by Martin Lipton and Zachary S. Podolsky, October 9, 2018](#)
- [A Synthesized Paradigm for Corporate Governance, Investor Stewardship, and Engagement, by Martin Lipton, Steven A. Rosenblum, Karessa L. Cain, Sabastian V. Niles, Sara J. Lewis and Anna Shifflet, April 4, 2017](#)
- [Coalition for Inclusive Capitalism](#)
- [Embankment Project of the Coalition for Inclusive Capitalism](#)
- [Engagement-Succeeding in the New Paradigm for Corporate Governance, by Martin Lipton, Steven A. Rosenblum, Karessa L. Cain and Sabastian V. Niles, January 2018](#)
- [Engagement: The Missing Middle Approach in the Bebchuk-Strine Debate, Matthew J. Mallow and Jasmin Sethi, New York University Journal of Law & Business, Vol. 12 No. 2, 385 \(Spring 2016\)](#)
- [Focusing Capital on the Long Term Global](#)
- [Investor Stewardship Group](#)
- [Larry Fink's Annual Letter to CEOs: A Sense of Purpose 2018](#)
- Prosperity: Better Business Makes the Greater Good, Colin Mayer, Oxford University Press 2018
- [Reforming Business for the 21st Century: A Framework for the Future of the Corporation, The British Academy, November 2018](#)
- [Social Capital, Corporate Purpose and the Revival of American Capitalism, by Steven Pearlstein, Center for Effective Public Management at Brooking, January 2014](#)

- [T.Rowe Price: Investment Philosophy on Shareholder Activism, June 2018](#)
- [The Error at the Heart of Corporate Leadership, by Joseph L. Bower and Lynn S. Paine, Harvard Business Review, May 1, 2017](#)
- [The New Paradigm: A Roadmap for an Implicit Corporate Governance Partnership Between Corporations and Investors to Achieve Sustainable Long-Term Investment and Growth, by Martin Lipton, Steven A. Rosenblum, Sabastian V. Niles, Sara J. Lewis and Kisho Watanabe, World Economic Forum, September 2, 2016](#)
- [Who Bleeds When the Wolves Bite?: A Flesh-and-Blood Perspective on Hedge Fund Activism and Our Strange Corporate Governance System, Leo E. Strine, Jr., 126 Yale L.J. 1870 \(2017\)](#)