Some Thoughts for Boards of Directors in 2022

The focus on climate change and other ESG issues, and on stakeholders generally, has been prompting boardroom deliberations around the recurring theme: "How do we take into account ESG and other stakeholder considerations, while at the same time addressing the expectations of our shareholders for robust financial results, stock price appreciation and dividends or other returns of capital? What is our legal responsibility?" Nearly every board-level corporate governance discussion we have had this past year has involved some version of these questions and the balancing act that they entail.

The proxy fight loss by Exxon earlier this year and the settlement of shareholder derivative litigation against the Boeing board are cogent illustrations of the significance of this challenge. Moreover, starting in 2016 with the publication by the World Economic Forum of The New Paradigm of corporate governance, and intensifying in 2019 with the shift away from shareholder primacy to stakeholder governance by the Business Roundtable, this has been the subject of intense discussion not only in boardrooms, but also in academia, the halls of legislators and regulators and by special interest groups.

The answer to this question when it was raised previously in the context of takeover defense, and the answer articulated more recently in the context of The New Paradigm of corporate governance, is that this is a classic business judgment question for the board of directors. The framework and guiding principles for a board's exercise of its business judgment are anchored in the purpose of the corporation, which provides actionable guideposts for corporate and fiduciary conduct and can be summarized as:

> The purpose of a corporation is to conduct a lawful, ethical, profitable and sustainable business in order to enable its success and increase in value over the long term. This requires consideration of all the stakeholders who are critical to its success (shareholders, employees, customers, suppliers and communities) as determined by the corporation and its board of directors using their business judgment and with regular engagement with its shareholders, who are essential partners in supporting the corporation's pursuit of its purpose. Fulfilling this purpose in this manner is fully consistent with the fiduciary duties of the board of directors, and the concomitant stewardship obligations of shareholders.

Viewed through this lens, the fundamental purpose of a for-profit corporation, and, accordingly, the decision-making calculus of boards, must include value-creation. However, corporations do not exist in a vacuum, but rather in a complex ecosystem of stakeholders. Every corporation relies on a multitude of stakeholder contributions and interests in order to operate effectively and create value. As with all business strategy, risk and operating decisions, it is essential to take into account the corporation's relationships with and the well-being of employees, customers, suppliers, communities and, more broadly, society and the environment at large.

Indeed, one takeaway from the ongoing Covid-19 pandemic has been the erosion of silos and the emphasis on the interconnectedness and co-dependencies of various constituents—for example, the far-reaching business and economic implications when the health and safety of employees are jeopardized, the ripple effect of bottlenecks and vulnerabilities in supply chain networks, and the sense of community that has been a motivating factor in the embrace of vaccines, masks and other behaviors aimed at reducing transmission rates. In this environment, many costs and risks that were previously viewed as externalities—including, but not limited to, climate change and environmental sustainability—are increasingly being taken into account by both corporations and investors as directly relevant to business strategy, risks and operations and financial results. The evaluation and weighing of these factors have also been facilitated by technological advances in processing and distilling large amounts of multi-dimensional data, so that increasingly attenuated linkages can be identified and quantified.

With all that said, the task and legal duty of a board of directors is fundamentally unchanged; it must use care and diligence and exercise its business judgment in weighing risks and opportunities to chart the path forward for the corporation. While the landscape of considerations that shareholders and other constituents expect directors to bear in mind has become increasingly broad and more complex, directors continue to be governed by the same legal duties.

In addition to the focus on ESG issues and stakeholder governance, the perennial themes of effective board functioning will be as important as ever—including with respect to board leadership, structure and composition, activism and defense preparedness, risk management, crisis management, succession planning and executive compensation. We recently highlighted these themes in our September 1, 2021 memo, Spotlight on Boards, which is attached.