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How Changing Corporate Purpose May Affect D&O Insurance

By **William Passannante**
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In an update of the Business Roundtable's "Statement of the Purpose of a Corporation," nearly 200 member CEOs eschew a sole focus on the shorter-term interests of shareholders in favor of "a fundamental commitment to all of our stakeholders." Those stakeholders are specified as employees, suppliers, communities and shareholders.

That change in narrative will prompt public discussion and developments in law — potentially leading to changes in the application of long-established rules related to whether a board of directors should focus solely on the short-term best interests of shareholders. The public discussion and developments in law will continue.

A change in focus from shareholder primacy to multiple constituencies may well lead to a reduced severity of shareholder claims, which historically have resulted in the most hazardous D&O liability insurance claims. Although other constituencies may be emboldened to bring novel D&O claims, it seems likely that such claims would be of a lower severity than those classic shareholder claims.

CEOs Redefine the Corporation's Stakeholders

The updated purpose statement asserts, "While each of our individual companies serves its own corporate purpose, we share a fundamental commitment to all of our stakeholders." It concludes, "Each of our stakeholders is essential. We commit to deliver value to all of them, for the future success of our companies, our communities and our country."

While many would consider these affirmations to be grounded in common sense, they may be in tension with threads in the history of corporate law. How that tension is resolved remains to be seen.

Delaware Law Remains Out-of-Step With the New Definition

While Delaware traditionally has focused on the benefit to a single constituency — shareholder primacy — other states have enacted statutes that permit or require the consideration of the impact of decisions upon other constituencies. For example, New York permits consideration of employees and retired employees entitled to receive retirement benefits and other stakeholders:

> (b) In taking action, including, without limitation, action which may involve or relate to a change or potential change in the control of the corporation, a director shall be entitled to consider, without limitation, (1) both the long-term and the short-term interests of the corporation and its shareholders and (2) the effects that the corporation's actions may have in the short-term or in the long-term upon any of the following:
>
> (i) the prospects for potential growth, development, productivity and profitability of the corporation;
>
> (ii) the corporation's current employees;
>
> (iii) the corporation's retired employees and other beneficiaries receiving or entitled to receive retirement, welfare or similar benefits from or pursuant to any plan sponsored, or agreement entered into, by the corporation;
>
> (iv) the corporation's customers and creditors; and
>
> (v) the ability of the corporation to provide, as a going concern, goods, services, employment opportunities and employment benefits and otherwise to contribute to the communities in which it does business.
>
> Nothing in this paragraph shall create any duties owed by any director to any person or entity to consider or afford any particular weight to any of the foregoing or abrogate any duty of the directors, either statutory or recognized by common law or court decisions.[1]

Delaware by contrast adheres to a focused rule, "When exercising their statutory responsibility, the standard of conduct requires that directors seek 'to promote the value of the corporation for the benefit of its stockholders.'"[2] For example, in a dispute involving the founders of Craigslist Inc., the founders argued that the company was permitted to favor communities or its users over shareholders. The Delaware Chancery Court found such behavior to be a breach of fiduciary duty owed to shareholders.

> Having chosen a for-profit corporate form, the Craigslist directors are bound by the fiduciary duties and standards that accompany that form. Those standards include acting to promote the value of the corporation for the benefit of its stockholders. The "Inc." after the company name has to mean at least that. Thus, I cannot accept as valid…a corporate policy that specifically, clearly, and admittedly seeks not to maximize the economic status of a for-profit Delaware corporation for the benefit of its stockholders.[3]

Over three decades ago, in Revlon Inc. v. MacAndrews & Forbes Holdings Inc., the Delaware Supreme Court "address[ed] for the first time the extent to which a corporation may consider the impact of a takeover threat on constituencies other than shareholders."[4] The court found that "while concern for various corporate constituencies is proper when addressing a takeover threat, that principle is limited by the requirement that there be some rationally related benefit accruing to the stockholders."

Much more recently, in Marchand v. Barnhill,[5] the Delaware Supreme Court suggested that it acknowledged the role that a compliance program has on shareholder value, which might be considered outside the short-term shareholder profit-maximizing approach.

The Delaware Supreme Court Chief Justice, Leo E. Strine, has noted that, "Revlon could not have been more clear that directors of a for-profit corporation must at all times pursue the best interests of the corporation's stockholders, and that the decision highlighted the instrumental nature of other constituencies and interests. Non-stockholder constituencies and interests can be considered… when giving consideration to them can be justified as benefitting the stockholders."[6]

Thus, according to Justice Strine's article, a multiconstituency approach might remain a shareholder primacy rule in different guise. Nonetheless, that articulation of the issue seems inconsistent with the aspirations of Business Roundtable's statement of the purpose of a corporation.

Impact Of D&O Liability and D&O Insurance Rates

The impact of the approach articulated in the Business Roundtable's purpose statement remains to be seen. Since so much of past D&O liability — and associated insurance coverage disputes — focused solely upon the impact upon short-term share price fluctuations, an approach that broadens the constituencies beyond shareholders probably will: (1) permit additional justifications for board decision making and reduce exposure related to share price fluctuations; and (2) possibly embolden other "new" constituencies to make claims against directors, though the absence of the multiplicative power of shares outstanding probably would render such claims less severe.

The somewhat mechanistic calculations of damages asserted by securities class action plaintiff's counsel might give way to a more pluralistic inquiry permitting corporations to broaden their defense to securities suits. Those counsel can be expected to resist this revised ethos, though judges may well credit the effort.

Such a forecast suggests that D&O liability insurance exposure and thus premium rates should, all things equal, be reduced by the adoption of a multiconstituency approach to director responsibility. In a nutshell, the impact of such a multiconstituency approach probably lowers severity of shareholder claims, and possibly emboldens other constituencies to assert claims with a lower level of severity. Perhaps D&O liability insurance underwriters can apply their forecasting ability to see into that lower severity future? These are interesting times in the world of D&O liability and insurance.

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[1] N.Y. BUS. CORP. LAW § 717(b)(i)-(v) (McKinney 1989).

[2] In re Trados Inc. S'holder Litig., 73 A.3d 17, 36-37 (Del. Ch. 2013).

[3] eBay Domestic Holdings, Inc. v. Newmark, 16 A.3d 1, 34 (Del. Ch. 2010).

[4] Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 176 (Del. 1986).

[5] No. 533, 2018, 2019 Del. LEXIS 310 (Del. June 18, 2019)

[6] Leo E. Strine Jr., The Dangers of Denial: the Need for a Clear-Eyed Understanding of the Power and Accountability Structure Established by the Delaware General Corporation Law, 50 WAKE FOREST L. REV. 761, 771 (2015).