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MILLSTEIN CENTER DIRECTOR PAPERS

Board Excellence and Fiduciary Duties of Corporate Directors

About the Article

This article is intended for corporate directors and explores the key issues that directors should understand with respect to their fiduciary duties. An accompanying paper authored by Ellen Odoner, Stephen Radin, Lyuba Goltser, and Andrew Blumberg of Weil, Gotshal & Manges LLP provides a detailed analysis of the concepts discussed in this article and is recommended to general counsel, as they advise their corporate boards with respect to their fiduciary duties, as well as directors who wish to have a better understanding of their own fiduciary duties.

This publication provides general information and should not be used or taken as legal advice for specific situations that depend on the evaluation of precise factual circumstances. The views expressed in this report reflect those of the authors and not necessarily the views of the Millstein Center, Columbia Law School, Columbia University, or the Center's partners and supporters.

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Board Excellence and the Fiduciary Duties of Corporate Directors

By Chief Justice E. Norman Veasey and Ira M. Millstein*

Introduction

The American legal framework of corporate governance, most manifest in the Delaware General Corporation Law, provides for a board-centric model. In simple terms, this means boards of directors are entrusted with the authority, and the corresponding responsibility, to manage the affairs of the corporation.¹ As a result, “directors are positioned at the epicenter of all corporate affairs, entrusted as the corporation’s ultimate authority.”² This is not a responsibility that can be delegated away to management or stockholders. Yet that is exactly the accusation leveled at boards these days. And in our current environment, an environment that can perhaps be best described as increasingly uncertain, directors have a more critical role than ever.

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Our goal here is not to provide a detailed explanation of director fiduciary duties. This is undertaken in an accompanying paper entitled *Fiduciary Duties of Corporate Directors in Uncertain Times*.³ Rather, it is to make clear that while the concepts of director fiduciary duties and the standards of reviews used by courts to evaluate whether directors have carried out such duties is not new, the context in which

directors are now making decisions is constantly evolving. This means, as elaborated upon in the accompanying paper, the steps required by directors to effectively carry out their fiduciary duties “will change in the specific context of the action the director is taking with regard to either the corporation or its stockholders.”

Consequently, directors have not only a legal but also a professional responsibility to understand their fiduciary duties and to act in accordance with them. So it concerns us that as we speak with directors, CEOs, general counsels, and investors, we continue to be asked a fundamental question: “to whom are fiduciary duties owed and what does that mean for director decision-making?” Much of the law and writing to date on fiduciary duties actually applies to what is often referred to as “special situations,” including takeover bids, going private transactions, proxy battles, corporate reorganizations and insolvency. Make no mistake—these special situations are important in the context of the board’s role and the corporation and its investors. But they are, by definition, special and do not answer the question of how directors discharge their duties in the day-to-day role they occupy on the boards they serve.

At the request of a group of general counsel convened by the Millstein Center at Columbia Law School and The Conference Board Governance Center, the Millstein Center published *Fiduciary Duties of Corporate Directors in Uncertain Times*, a paper on director fiduciary duties authored by Ellen Odoner, Stephen Radin, Lyuba Goltser, and

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Andrew Blumberg of Weil, Gotshal & Manges LLP. As the paper makes clear, fiduciary duties are nuanced and contextual duties. With this article, we aim to provide guidance and clarity to directors as they try to apply the concept of fiduciary duties to their role as directors of the corporation in an increasingly complex business environment.

To Whom Your Duties Are Owed

Every director is legally obligated to discharge his or her duties in good faith and in a manner that the director honestly believes to be in the best interests of the corporation. Additionally, directors owe both a duty of care and a duty of loyalty to the corporation they are entrusted to protect. As directors, you have heard this countless times. But understanding what this actually means for directors is complicated. Many commentators have opined on the topic, and scholarship among the legal academic community is far from unanimous. Many directors and practitioners are quick and confident to say that directors owe their fiduciary duties to the shareholders. How does one reconcile the legal duty with this common misapprehension?

The law is clear, fiduciary duties are owed to the corporation, and thus to **all** shareholders. But how does a director think about the interests of all shareholders? Shareholders are a diverse group, from mom and pop retail investors to sophisticated hedge funds, mutual funds, and everything in between. Their interests are equally diverse, from the high-frequency trader that is looking simply to move the stock quickly and to make a penny here and a penny there, to the worker that has his or her retirement invested and needs that nest egg to grow over the next 30 years to ensure a comfortable retirement. Again, however, the law is clear: the duty is to all of them.

Directors cannot hold the interests of one shareholder or one set of shareholders above the others. And so, there is only one way to understand your

fiduciary duties when you must consider the interests of all shareholders, and your shareholders are so different—it is to the interests of the corporation.

The Interests of the Corporation

Being a director of a modern corporation is no small task. The days of board meetings centered on golf outings and martinis are long past. A more apt description of the role of today's directors may be herculean. Such is the responsibility that they bear.

The law, principally through the business judgment rule, gives directors important and incredible flexibility to make the decisions, to take the prudent risks, and to pursue the critical innovation and growth that ultimately marks the success of a corporation. It is important for directors to understand and know that if they follow a thoughtful process, and are true to their duties of care and loyalty, they can, and they must, do what is right for the corporation.⁴

Now it is also true that beyond the courts of justice, the courts of public opinion and the markets influence decision-making in the boardroom. Each board must make the decisions that are right for their company. But it is important for directors to keep in mind that when the final judgment is rendered, the standards of behavior are clear.

This is the critical point. Directors are empowered to make decisions that are in the long-term interests of the corporation. In other words, the law liberates directors from succumbing to short-term pressures. This may mean missing a quarter to invest in innovation. It will certainly mean taking calculated business risks. And it will mean pushing back firmly against short-termism from the markets when the board believes its long-term strategy is the right one for the corporation.

But it may well also mean that a sale of the company generates more value for shareholders than remaining independent, or that a hedge fund does

have the right strategy that the board and management missed. The point is that the only people in a position to make those distinctions are the directors. They—the directors—are the “ultimate authority.”

A Critical Ally in Pursuit of the Corporation’s Best Interests

While the business judgment rule, which provides a presumption that in making a business decision the directors acted on an *informed basis*, in good faith and in the honest belief that the action taken was in the best interests of the corporation, is the default standard of review by courts when evaluating director decisions, the key is that directors must in fact act on an informed basis and in good faith. This means that directors must be able to follow a process that will pass the court’s review during these extraordinary times.

And that is where the General Counsel comes in. No two litigated cases are exactly alike, and no two court decisions are based on the same fact pattern. Rather, the specific circumstances are crucial to the court’s review of whether the members of the board fulfilled their fiduciary duties. Yet, directors cannot be expected to understand all of the nuances of existing case law.

As has recently been outlined in numerous articles, but most thoroughly and importantly in two recent books, “The Indispensable Counsel: The Chief Legal Officer in the New Reality,” by E. Norman Veasey and Christine T. Di Guglielmo and “The Inside Counsel Revolution: Resolving the Partner-Guardian Tension,” by Ben W. Heineman, Jr., the role of General Counsel has transformed significantly. It is important for directors to understand this transformation.

These changes to the role were in response to the challenges presented by a rapidly changing global marketplace. Today, the role of General Counsel is pivotal to the affairs of the corporation. “The general

counsel is a key player—perhaps the key player—in this new reality. While navigating the demands and interests of the various constituencies, the chief legal officer must remain ever vigilant to serve the best interests of the client—the corporation itself.”⁵ And directors should expect no less from their own General Counsel.

Facing growing scrutiny from shareholders, proxy advisors, and regulators, boards should look to their General Counsel for not only legal advice, but also strategic advice as the board works through difficult decisions for the future of the corporation. This includes not only actively seeking advice to ensure that they are fulfilling their fiduciary duties by participating in informed processes when making decisions, but also seeking guidance with respect to matters such as corporate strategy, shareholder engagement, and risk management.

Whether or not the General Counsel is a member of the board, the General Counsel should be part of board culture. This means that each individual director should forge a relationship with their General Counsel, feeling confident that he or she can rely on the General Counsel for advice when making decisions.⁶

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What this Means for Directors

Directors, working closely with their General Counsel to ensure they are making decisions based on an informed process that will withstand legal scrutiny, are empowered, and have the freedom, to make decisions they deem in the best interests of the corporation, working towards securing the long-term future of their corporations. Said more forcefully, it is your duty to make decisions in that manner.

The law does not distinguish between directors making decisions that will promote the short-term versus long-term growth of the corporation. Rather, the key is whether directors followed the requisite process when making decisions. More importantly, secure in their thoughtful and reasonable decision-making process, directors should work towards striking a balance between investing in long-term corporate growth and innovation and delivering short-term value to shareholders, when possible.

Admittedly, there is always risk in investing in the long-term performance of the corporation, especially when this means foregoing immediate profits or the boosting of share prices. The alternative risk, and in our opinion a more dangerous one, is the risk of focusing only on short-term results and foregoing innovation and growth to the point where a corporation cannot be sustainable in the future. This appears to be the case far too often in our modern economy. Directors are in the difficult position of evaluating which risk is greater and must ask themselves what is the right thing to do—Not what is the easiest thing to do, but the right thing to do.

Directors should take solace in knowing that they are legally empowered, indeed that is their duty, to do what they deem is in the best interests of the corporation. When this is done, all of your shareholders will benefit.

ENDNOTES

¹ E. Norman Veasey and Christine T. Di Guglielmo, “The Indispensable Counsel: The Chief Legal Officer in the New Reality.” (Oxford University Press, 2012).

² Ira M. Millstein, “The Activist Director: Lessons from the Boardroom and the Future of the Corporation.” (Columbia University Press, 2016).

³ Published by the Millstein Center for Global Markets and Corporate Ownership at Columbia Law School and Weil, Gotshal & Manges LLP.

⁴ For a detailed discussion of standards, see *Fiduciary Duties of Corporate Directors in Uncertain Times*, pages 5–8.

⁵ E. Norman Veasey and Christine T. Di Guglielmo, “The Indispensable Counsel: The Chief Legal Officer in the New Reality.” (Oxford University Press, 2012).

⁶ See Ben W. Heineman, Jr., “The Inside Counsel Revolution: Resolving the Partner-Guardian Tension.” (American Bar Association, 2016).

About the Authors

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The mission of the Millstein Center for Global Markets and Corporate Ownership is to bring world class scholarship, research and academic rigor to the vital task of restoring and strengthening long-term financing of innovative and durable public corporations, which are the underpinning of economic growth.

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