
PREFACE TO THE THIRD EDITION: PREPARATIONS AND PERSPECTIVES

As the first casebook devoted specifically to corporate governance, this book identifies and suggests responses to unresolved issues in addition to reviewing current law and practice.¹ Although their analyses are not intended or offered as legal advice, the chapters are designed not only for consideration by law school² and business school³ classes, but also to support the immediate and practical work of boards of directors, individual directors and officers, shareholders, stakeholders, and their counsel.

In order, the chapters introduce competing theories of corporate governance (Chapter 1); analyze the directors' and officers' fiduciary duties of care (2) and loyalty (3); examine the types of shareholders (4) and the shareholders' power to nominate and elect directors (5); review the corporation's methods and philosophies of determining executive compensation (6) and of engaging in corporate social responsibility initiatives (7); and address the professional ethics responsibilities of in-house and outside counsel for the corporation and its various constituents (8).

The myriad, often overlapping, and sometimes conflicting rules, principles, and "best practices" of corporate governance are themselves constantly evolving, through the interactions of legislators, regulators, courts, stock exchanges, industry groups, proxy advisors, institutional investors, shareholder and/or social activists, academic and other commentators, and prevailing public sentiments.⁴

In helping clients safely navigate through these complexities and uncertainties, lawyers must continually anticipate problems that could arise, and determine how they might be prevented or resolved. Counsel for corporations, boards, directors, officers, or shareholders thus practice what Secret Service agents call, in a much

1. The discussions in the chapters generally reflect developments through August 2021.

2. See Jenna L. LaRoche, *Corporate Governance Is "Hot Topic" for Law School Courses*, BNA Corp. Gov. Rpt., July 7, 2008, p. 80.

3. See Michael Jacobs, *How Business Schools Have Failed Business*, Wall St. J., April 27, 2009, p. A13 (noting, as a business school professor, that "[b]y failing to teach the principles of corporate governance, our business schools have failed our students").

4. See, e.g., Stephen M. Bainbridge, *Corporate Governance After the Financial Crisis 270* (2012) (concluding that the corporate governance provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, like those of the Sarbanes-Oxley Act of 2002, constitute "quack corporate governance": That is, "[a] powerful interest-group coalition centered on activist institutional investors hijacked the legislative process so as to achieve long-standing policy goals essentially unrelated to the causes or consequences of the financial crisis that began back in 2007").

different context, “situational awareness”: that is, “thinking of the many things that could go wrong, and what you would do if one of those things happened.”⁵

Beyond educating their clients about existing rules, lawyers can recommend everyday practices to forestall emergencies. For example, just as marathoners are advised to avoid dehydration by drinking frequently in the early miles of their races (even when they are not yet thirsty),⁶ so can a board of directors be urged to develop and regularly review policies concerning such areas as executive compensation and conflicts of interest.

Counsel can also, well in advance, prepare strategies and tactics to be deployed in crises, rather than conducting a frenzy of initial research in the midst of such a situation. As one chess columnist recently warned his readers, “[s]erious players must master basic endgames. . . . Figuring them out during a game is difficult, if not impossible.”⁷

In suggesting forward-looking measures of both kinds, *Corporate Governance: Principles, Practices, and Provisions* (the last term, *Provisions*, has been added to reflect an increased emphasis on drafting techniques), combines the features and functions of a casebook, a sourcebook, and a workbook. This fully updated third edition explains the concepts and major elements of the relevant laws, often with the aid of excerpts from and references to court decisions (including more than two hundred decisions newly added)⁸ and references to recent news reports⁹ and examples from popular culture. The footnotes and appendices suggest numerous resources for further research.

Among the major additions introduced by this edition are:

- Composite provisions, displayed in “boxed” format and patterned on the corporate governance guidelines of major corporations, illustrating issues in and approaches to drafting such documents.
- Practical new appendices, “On Preparing and Presenting ‘Actionable’ Advice” (Appendix B) and “Ten Tips Towards Transparency in Posting Core Corporate Documents” (Appendix C); and a revised and updated list of “Recommended Resources for Corporate Governance Research” (Appendix A).

5. Christopher Falkenberg, *Frequent Flier: Always Mindful of Finding the Nearest Exit*, N.Y. Times, Sept. 8, 2009, p. B6.

6. Gordon Block, *How to Train for and Run Your Best Marathon* 146-147 (1993) (recommending, “[d]o not wait until you are thirsty before you drink. By then it is too late, and you will have a tough time ‘making up’ the volume of water you have lost through perspiration.”).

7. Dylan Loeb McClain, *They’re No Fun to Learn, But Endgames Lead to Wins*, N.Y. Times, Sept. 13, 2009, p. 34 (adding, “Studying endgames are [sic] the chess equivalent of eating your vegetables. Part of what makes it a chore is there is no guarantee the knowledge will ever be useful.”).

8. Excerpts from commentary and caselaw do not always indicate the removal of footnotes or citations.

9. Citations to newspaper articles generally reproduce the capitalization of the original sources. Citations to, and/or quotations from, the works of politicians are not intended to be taken as the author’s endorsements, or criticisms, of those individuals personally or of their (or their respective parties’) political positions.

- In Chapter 1, enhanced discussion and new examples of the thematic underpinnings of the study, theory, and practice of corporate governance, as well as material from the former Chapter 10 (concerning governance rankings and attempts to assess empirically the value of various governance mechanisms).
- Throughout Chapter 2, expanded treatment of the directors' responsibility to identify and reduce risk to the corporation, and of methods of doing so (including special issues of cybersecurity); and analyses of the applicability of *Robert's Rules of Order* to board meetings; of variable/differential voting powers of directors; and of emergency bylaws.
- In Chapter 3, new discussions of meetings in "executive session," and of the viability of a policy against a company's directors' dating each other; and additional material on activities and public comments of executives that, while not illegal, might embarrass their companies; special responsibilities of members of the audit committee; and the composition and role of the executive committee.
- In Chapter 4, expanded treatments of virtual meetings of shareholders, of the rules of conduct for shareholder meetings, and of forum selection provisions for intracorporate litigation; and new sections on "loyalty shares"/"tenure voting," on fee-shifting provisions, and on mandatory arbitration provisions.
- In Chapter 5, new examinations of increased efforts (and in some circumstances, mandates) to diversify the composition of boards; the "financial literacy" requirement for (some) directors; enabling the CEO to also serve as the board chair; the role of the "executive chair"; "golden leashes" for directors; the roles and responsibilities of advisory board members, advisory directors, emeritus directors, honorary directors, and board observers; proxy access proposals; and "refreshing" the board through age and term limits.
- Expanded discussions in Chapter 6 of clawbacks; restrictions on executives' pledging and hedging the company stock that they hold; Key Employee Retention Plans (KERPs) in bankruptcy situations; "golden hellos" and "say on pay" litigation; and a new analysis of the 2017 requirement of pay ratio disclosure.
- In Chapter 7, new material on ESG (Environmental, Social, and Governance) issues and on social enterprises.
- In Chapter 8, additional material on the lawyer's role as "gatekeeper," as well as new discussions of: the role, and relationship to corporate counsel, of the chief compliance officer; of the "Yates Memo" (2015); and of additional considerations in effective and ethical corporate counseling.

Some readers might find *Corporate Governance* most useful for its hundreds of questions, which generally identify practical operational concerns, a number of which have been addressed on the author's blog, governancedrafting.com (launched in late December 2020), from which some elements of this new edition have been adapted: for example, "[s]hould a corporation adopt a policy that no directors create their own personal notes at board and/or committee meetings—or that if they do take notes, all such notes should be destroyed before the directors leave the meeting room?"¹⁰ Many questions focus on productive topics

10. Section 2.02(C)(2), Question 22.

for a lawyer to discuss with clients, especially since they are not usually addressed by standard corporate forms and “menus” of drafting options.¹¹

Yet this work is not a “cookbook”: many of its questions, unlike their counterparts in mathematics and science textbooks, have no precise and definitive answer to be provided “in the back of the book.” Instead, whether, when, and how to address the issues they raise could vary in practice, according to the nature of the client and of its particular situation. Moreover, a client’s response might range from postponing consideration of an issue to developing a checklist of substantive and procedural factors for creating a future policy to quickly formulating and adopting specific corporate rules.

Among the perspectives from which practitioners, executives, investors, students, and faculty might approach the chapters’ questions are the following:

- (1) Historical: How has this issue generally been addressed?
- (2) Positive/Descriptive: How are corporations currently resolving the issue posed? What factors do they take into account in choosing procedures and/or rules to follow?
- (3) International/Comparative: How are corporations in other countries dealing with the issue?
- (4) Empirical: What percentages of which types of corporations have resolved the issue by each of the methods so far adopted? How, if at all, can such resolutions be correlated with a change in the market value of a corporation’s stock, and/or with other objective indicators of the firm’s performance?
- (5) Normative/Prescriptive: How *should* the issue be resolved, and what social and legal policies justify that resolution?
- (6) Document Drafting: What language could be added to (or revised in) an existing corporate document to resolve the issue? If a new corporate document should be created to address the matter, what type of document should it be, and what should it provide?
- (7) Legislative/Regulatory Drafting: Should this issue be addressed by legislation—and if so, by state rather than federal legislation? How should any such legislation be worded? Should it be enabling (that is, allowing corporations the option of adopting a certain practice), or mandatory (requiring that practice)?
- (8) Judicial/Litigation Drafting: Have courts deciding this issue agreed with each other? Have their opinions left practical elements of the issue vague or unresolved? In litigation of this issue, what language should counsel urge courts to adopt in their decisions?

11. Cf. Stacy Conradt, 10 Secret Menu Items at Fast Food Restaurants, Sept. 28, 2009, available at cnn.com/2009/LIVING/wayoflife/09/28/mf.10.secret.menu.items/index.html?iref=newssearch (identifying such unadvertised items as the “short” size of Starbucks coffee and unpublicized policies as Chipotle’s, which “says that if they have the [test] item available, they will make it for you.”).

- (9) Aspirational: To what degree should the law and culture of corporate governance extend beyond discouraging directors and officers from abusive practices (by exposing them to personal civil and/or criminal liability) to encourage them to engage in “best practices”? For instance, one leading corporate court has stated that “Delaware law does not—indeed, the common law cannot—hold fiduciaries liable for a failure to comply with the aspirational ideal of best practices.”¹² Where are the lines between abusive, appropriate, and aspirational practices for directors and officers, and how clearly should they be drawn? When, why, and how should a lawyer recommend that a client pursue “best practices” rather than those that are legal but merely average or acceptable?
- (10) Ethical: What concerns of professional responsibility and malpractice does the resolution of the issue raise for the lawyer?

Sixty years ago, a leading commentator reviewed the extraordinary degree of flexibility permitted management by corporate statutes, and mourned that

corporation law, as a field of intellectual effort, is dead in the United States. When American law ceased to take the “corporation” seriously, the entire body of law that had been built upon that intellectual construct slowly perforated and rotted away. We have nothing left but our great empty corporation statutes—towering skyscrapers of rusted girders, internally welded together and containing nothing but wind.¹³

Many provisions of modern corporate statutes remain flexible, enabling, and permissive rather than rigid, mandatory, and restrictive. Yet for the reasons discussed in the following chapters, today’s corporate law professors and practitioners see significant areas of the legal architecture redeveloped, refurbished, and refurnished, and less wind-swept than ever.

This book, and its new Online Supplement, available at www.AspenPublishing.com/Effross-CorpGov3, attempt to provide some maps and tools for creating secure spaces within new and ongoing construction zones and for maximizing corporations’ and their participants’ potentials, plans, and progress.

12. *In re Walt Disney Co. Derivative Litigation*, 907 A.2d 693, 697-98 (Del. Ch. 2005).

13. Bayless Manning, *The Shareholder’s Appraisal Right: An Essay for Frank Coker*, 72 *Yale L.J.* 223, 245 n.37 (1962).