Lipton vs. Lucian

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It's no "Thrilla in Manila," but a rematch between two governance heavyweights could help define nothing less than the purpose of corporations. Lucian Bebchuk, a professor at Harvard Law School, last week slammed as "illusory" the notion that top executives would stop favoring shareholders over workers, customers and other stakeholders – despite promises to do so. Veteran lawyer Martin Lipton promptly countered that business, political and social forces are already moving companies past shareholder primacy. It's a brawl that's more than academic.

Bebchuk and Lipton last squared off in public about five years ago, when the issue was so-called staggered boards: whether all directors rather than, say, one-third of them should face re-election each year. The professor and his activist-investor allies championed annual votes as an antidote to entrenched management, while Lipton and his partners at Wachtell, Lipton, Rosen & Katz touted the stabilizing benefits of staggered ballots. The debate still rages.

The current controversy emerged after the Business Roundtable presented a pledge last August from JPMorgan boss Jamie Dimon, Amazon.com's Jeff Bezos and 179 other corporate leaders to run their companies for all stakeholders. The likes of the World Economic Forum and Larry Fink, BlackRock's chief executive, issued similar proclamations, and Lipton and his firm declared 2019 a "watershed year" in corporate governance. The shareholder, they said, should no longer be king.

That position makes some sense. After all, the corporate form arose from the English notion that only entities that benefited the public – like water suppliers – deserved its most important attribute: limited liability for owners. By the 1920s, though, the prevailing legal wisdom was that managers' primary duty was to shareholders, the people who elected directors and essentially owned the company. Views began to shift in the aftermath of the 2008 financial crisis and corporate scandals like Boeing's botched development of the 737 MAX aircraft, which exposed flaws in the theory that serving investors necessarily created long-term value.

At first sight it is surprising that Bebchuk, a persistent boardroom watchdog, would oppose broadening management accountability – or that Lipton, defender-in-chief of boards and managers, would embrace it. Yet the argument Bebchuk presents in his article is more nuanced than that. He sees a need to protect stakeholders, but he doesn't trust companies, or the market, to do it.

For starters, he argues that, to the extent serving a wider group of stakeholders increases shareholder value by, say, allowing a company to attract more productive employees, managers will do it anyway. That not only makes it superfluous but creates the possibly misleading impression that actual changes to laws and rules are unnecessary. What's more, the difficulty of deciding who counts as a stakeholder and how to balance conflicting interests leaves, in Bebchuk's view, too much discretion to management.

And managers often have powerful incentives to favor shareholders over everyone else. Directors and top executives at companies from Oracle to Johnson & Johnson are paid largely in equity, aligning their interests with those of shareholders. Their job security also typically depends on keeping their companies' stock prices high. As evidence of what happens in practice, Bebchuk cites the 10 largest private-equity acquisitions to show that target companies consistently bargain to protect management and shareholders but not workers, suppliers or local communities – even when state laws explicitly allow them to take account of constituents other than investors.

The upshot, according to Bebchuk, is that making corporate leaders accountable to more people makes them less clearly accountable to anyone. They can use supposed obligations to non-shareholders as a shield against takeovers, activist investors and lawmakers – important forces for disciplining companies. As a result, he says, both shareholders and other stakeholders end up weakened. A possible solution: regulations and laws that enshrine duties to workers, consumers, the environment and others.

In a testy memo, Lipton and his partners responded to Bebchuk by citing more than a dozen articles that make the case for stakeholder-based governance. The law, they argued, not only permits it, but "practical business, political and social imperatives require it." They accused Bebchuk of using "cherry-picked data" and promoting the views of activist hedge funds like Elliott Management, which, they say, undermine long-term value and "the social good."

The biggest hole in Lipton et al's thesis may be their belief that corporate executives should be left to serve their stakeholders without being told how. They say new laws might sweep too broadly, destroy corporate value and hinder investors and companies from crafting better solutions themselves. That's consistent with their past faith in managers, but not particularly persuasive.

The law may already be changing. In several recent cases, Delaware courts have, at least implicitly, expanded boards' duty to shareholders to include consideration of non-shareholder interests. Last August, for example, the state's then-Supreme Court Chief Justice Leo Strine scolded directors of Blue Bell Creameries for not paying enough attention to the people who would eat contaminated batches of their ice cream. Many individual investors along with big asset managers like BlackRock are shifting their priorities, too. Less obvious to date is any significant movement away from paying executives on stock-based criteria.

Lipton's history makes him vulnerable to Bebchuk's claim that "stakeholderism" is simply another way for executives to deflect scrutiny. Yet the attorney and his firm were early champions of the idea that businesses should serve employees, customers and the environment in addition to shareholders, one which has gained broad support. Bebchuk, meanwhile, risks sounding as though he's dismissing it out of hand, even though he isn't. However the debate plays out, having it publicly should ultimately bring better ideas to governance – and that's genuinely good for all corporate constituents.