TOWARD A FAIR AND SUSTAINABLE CORPORATE GOVERNANCE SYSTEM: REFLECTIONS ON LEO STRINE, JR.'S WRITING ON INSTITUTIONAL INVESTORS

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INTRODUCTION

It is a privilege to contribute to this Festschrift for my friend, mentor, and co-author, Leo Strine, Jr. It is also a pleasure to revisit his vast body of work and to re-experience the breadth and depth of his scholarship, as well as reflect on his unparalleled influence on the development of corporate law that he brought about while presiding over its most influential courts for twenty-one years.

In thinking about this essay, I recalled a conversation that I had with "CJS" when I was serving as his law clerk.[1] In this conversation, he decried (with James Taylor blasting in the background) how institutional investors discharged their fiduciary duties, directing me to a study that revealed,

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1. "CJ" is the acronym used for the Chief Justice of the Delaware Supreme Court. I was lucky to work for him during his first full year bearing that title.

disappointingly, that so-called "green" mutual funds voted no differently than their "brown" counterparts. The conversation was a revelation to me; it launched me on a path of considering how institutional investors wield their substantial power and what agency problems might stand in the way.[2]

As this essay will demonstrate, Chief Justice Strine[3] was one of the first to highlight these problems (coining the phrase "the separation of ownership from ownership"[4]) and propose reforms. In his final year of judicial service, he drafted legislation that would crystalize many of these ideas, garnering support from many legislators.[5] Since that time, he has continued to push institutional intermediaries to take a broad view of their duties, observing that their beneficiaries may also be workers, and are always human beings with interests in clean air and water.[6] In his scholarship and advocacy, Chief Justice Strine has been extremely influential, driving reforms of governance practices at major institutions and influencing government bodies at the state and federal level to focus on these issues.[7]

In this essay, I highlight some of Chief Justice Strine's many contributions to our understanding of institutional investors, their incentives, and their duties. In so doing, I focus on his scholarship rather than his jurisprudence, although these issues have also come up in the latter.[8] I also

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2. My first project on this subject—*The Case Against Passive Shareholder Voting*, 43 J. CORP. L. 493 (2018)—was a great disappointment to my friend and mentor, who, as will be discussed, had spent the past decade viewing passive shareholders as an important check on investor short-termism, and particularly hedge fund activism. Thankfully, CJS and I had a long history of friendly disagreement, and so I took his dim view of my paper as an invitation to convince him to take my position seriously, an invitation that I continue to accept in Part III of this essay.

3. I refer to my friend and mentor as Chief Justice Strine throughout this essay, even though he bore other titles at different periods of his judicial service, including Chancellor and Vice Chancellor.

4. Leo E. Strine, Jr., *Toward Common Sense and Common Ground? Reflections on the Shared Interests of Managers and Labor in a More Rational System of Corporate Governance*, 33 J. CORP. L. 1, 6 (2007).

5. Leo E. Strine, Jr., *Toward Fair and Sustainable Capitalism: A Comprehensive Proposal to Help American Workers, Restore Fair Gainsharing between Employees and Shareholders, and Increase American Competitiveness by Reorienting Our Corporate Governance System Toward Sustainable Long-Term Growth and Encouraging Investments in America's Future* (U. Pa. Inst. for L. & Econ., Research Paper No. 19–39, 2019), https://dx.doi.org/10.2139/ssrn.3461924.

6. Leo E. Strine, Jr., *Stewardship 2021: The Centrality of Institutional Investor Regulation to Restoring a Fair and Sustainable American Economy* (Colum. L. & Econ., Working Paper No. 633, 2020), http://dx.doi.org/10.2139/ssrn.3719145.

7. *See infra* Parts II and III.

8. Interestingly, and somewhat in tension with his advocacy, Chief Justice Strine's jurisprudence has emphasized the increasing sophistication of the shareholder base and

discuss some of the policy proposals that Chief Justice Strine has advanced that would change the incentive environment for institutional investors, and also address their outsized influence relative to other corporate stakeholders. In so doing, I hope to not only reflect on Chief Justice Strine's extensive contributions to this area of law, but also influence his many remaining years of scholarship and advocacy. And in writing this essay, I will highlight themes that are reflective of Chief Justice Strine's approach: in particular, his "clear-eyed" view that takes as his starting point what the law is, rather than what it should be; his willingness to modernize and humanize stale legal frameworks; and his desire to make the world a better place for ordinary people.[9]

I. MAJOR MOVES

It is no overstatement to say that corporate law scholars have been preoccupied with the problem of separated ownership and control since it was described by Adolf Berle in 1931.[10] At that time, Berle observed that

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greater access to information as support for deferential judicial review of decisions approved by shareholders. *See, e.g.*, *In re* Cox Commc'ns, Inc. S'holders Litig., 879 A.2d 604, 619 (Del. Ch. 2005) ("And, with increasingly active institutional investors and easier information flows, stockholders have never been better positioned to make a judgment as to whether a special committee has done its job."); *In re* MFW S'holders Litig., 67 A.3d 496, 530 (Del. Ch. 2013) ("Market developments in the score of years since have made it far easier, not harder, for stockholders to protect themselves. With the development of the internet, there is more public information than ever about various commentators', analysts', institutional investors', journalists' and others' views about the wisdom of transactions . . . . Not only that, institutional investor holdings have only grown since 1994, making it easier for a blocking position of minority investors to be assembled. Perhaps most important, it is difficult to look at the past generation of experience and conclude that stockholders are reluctant to express positions contrary to those espoused by company management."). For one example of the tension between these deference doctrines and voting outcomes, see Sean Griffith & Dorothy Lund, *Conflicted Mutual Fund Voting in Corporate Law*, 99 B.U. L. REV. 1151 (2019).

9. *See, e.g.*, 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, 768 (2015). Chief Justice Strine was an inspiring person to work for because he took seriously every single issue that came before him, whether it be a lawsuit involving a billion-dollar M&A transaction or a protracted custody battle. Some of our most interesting discussions involved worker's compensation disputes, pretty crime, and family court issues, where CJS demonstrated his steadfast commitment to justice. Indeed, toward the end of his judicial career, CJS focused substantial efforts to improving Delaware's criminal justice system, including by authoring the lead decision holding Delaware's death penalty statute unconstitutional, and improving access to justice and addressing systematic racism.

10. *See* Adolf A. Berle, Jr., *Corporate Powers as Powers in Trust*, 44 HARV. L. REV.

dispersed shareholders of large publicly held companies were unlikely to constrain management, necessitating reforms to minimize what are now called agency costs.[11] The growth of institutional investors somewhat changed this picture: by the 1990s, these large blockholders were crowding out individual investors,[12] leading some observers to claim that they could put an end to the problems identified by Berle.[13] And yet, things didn't exactly play out that way—the largest institutional investors were mutual funds, which tended to take a relatively passive approach to corporate governance.[14] Other investors were better positioned to intervene, but questions about their incentives remained.[15]

Understanding how large institutional investor blockholders wield their substantial power became an important area of corporate governance scholarship, drawing contributions from heavy hitters and emerging scholars alike.[16] But before this literature developed into a robust area of scholarly

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1049 (1931); ADOLF A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY 333–57 (1932); *see also* Dorothy S. Lund & Elizabeth Pollman, *The Corporate Governance Machine*, 121 COLUM. L. REV. 2563 (2021) (reflecting on the fact that these themes have emerged earlier than 1931).

11. *Id.*; *see also* Michael Jensen & William Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976); Zohar Goshen & Richard Squire, *Principal Costs: A New Theory for Corporate Law and Governance*, 117 COLUM. L. REV. 767, 770 (2017) (discussing "agency-cost essentialism").

12. Paul A. Gompers & Andrew Metrick, *Institutional Investors and Equity Prices*, 116 Q.J. ECON. 229, 236 (2001) (showing that by 1996, institutional investors held 50% of the U.S. equity market).

13. *See, e.g.*, Roberta Romano, *Public Pension Fund Activism in Corporate Governance Reconsidered*, 93 COLUM. L. REV. 795, 795–853 (1992); Bernard Black, *Agents Watching Agents: The Promise of Institutional Investor Voice*, 39 UCLA L. REV. 811 (1991); Bernard Black, *Shareholder Passivity Reexamined*, 89 MICH. L. REV. 520, 575–91 (1990).

14. For early discussions of both the promise and pitfalls of institutional shareholder activism, as well as proposals for reform, see Ronald J. Gilson & Renier Kraakman, *Reinventing the Outside Director: An Agenda for Institutional Investors*, 43 STAN. L. REV. 863 (1991); Roberta Romano, *Less is More: Making Institutional Activism a Valuable Mechanism of Corporate Governance,* 18 YALE J. ON REGUL. 174, 175 (2001); Jill Fisch, *Relationship Investing: Will it Happen and Will it Work?*, 55 OHIO ST. L.J. 1009 (1994); *see also* Ronald J. Gilson & Jeffrey N. Gordon, *Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights*, 113 COLUM. L. REV. 863 (2013).

15. Romano, *supra* note 13; Marcel Kahan & Edward B. Rock, *Hedge Funds in Corporate Governance and Corporate Control*, 155 U. PA. L. REV. 1021 (2007).

16. I am unlikely to capture in this note all of the scholarship that has addressed these problems, but for a small sample, see Kahan & Rock, *supra* note 15 (discussing hedge fund incentives); John C. Coffee Jr. & Darius Palia, *The Wolf at the Door: The Impact of Hedge Fund Activism on Corporate Governance*, 41 J. CORP. L. 545 (2016) (discussing the same); Romano, *supra* note 13 (discussing pension fund incentives); Stephen J. Choi & Jill E. Fisch, *On Beyond CalPERS: Survey Evidence on the Developing Role of Public Pension Funds in*

inquiry, Chief Justice Strine's scholarship had repeatedly emphasized the main themes that have come to shape these conversations: the largest institutional investors have ample raw power, and yet, they don't seem to use it very well, even when judged by the standards of improved corporate performance and shareholder wealth creation. Instead, they tend to follow other investors with better incentives to be active in governance, but who may be pursuing their own self-interest at the expense of long-term growth and value. In addition, Chief Justice Strine's early observations about the individual investors that entrust their money to institutional investor intermediaries have transformed the way that we think about the duties of portfolio managers, as well as fiduciary duty more generally. In this Section, I highlight these themes and how they have evolved in Chief Justice Strine's scholarship over the past two decades.

A. Separation of Ownership from Ownership

In 2003, well before long before most corporate law scholars focused on the problem of flawed institutional intermediaries, Chief Justice Strine highlighted these issues in an article (with Chancellor Chandler) that evaluated Sarbanes Oxley's corporate governance reforms.[17] In discussing the Act's definition of independence that looked askance at large shareholders, the authors pointed out that large institutional blockholders had the potential to be active participants in governance and in so doing, represent the interests of the millions of individual investors who entrusted their capital to them.[18] But rather than participate actively and thoughtfully, these large institutions had instead "le[ft] the actual hard work of governing corporations to others."[19]

Chief Justice Strine focused on this misalignment in greater depth in 2006, in his response to Lucian Bebchuk's influential article, *The Case for Increasing Shareholder Power*.[20] In *Toward a True Corporate Republic*,

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Corporate Governance, 61 VAND. L. REV. 315, 339 (2008) (discussing the same); Gilson & Gordon, *supra* note 14 (discussing mutual funds and incentives); Lucian A. Bebchuk, Alma Cohen & Scott Hirst, *The Agency Problems of Institutional Investors*, 31 J. ECON. PERSPS. 89 (2017) (discussing the same).

17. William B. Chandler III & Leo E. Strine, Jr., *The New Federalism of the American Corporate Governance System: Preliminary Reflections of Two Residents of One Small State*, 152 U. PA. L. REV. 953 (2003).

18. *Id.*

19. *Id.* at 996. The authors, among other things, blamed the fact that institutions "tended to hold short-term positions." *Id.* at 990 n.95.

20. Lucian A. Bebchuk, *The Case for Increasing Shareholder Power*, 118 HARV. L. REV. 833 (2005).

Chief Justice Strine discussed the practical effect of Bebchuk's proposals to empower shareholders: they would serve to empower institutional investors whose "incentives [were] not identical to those of the individual investors whose capital they control."[21] For example, mutual funds often seek to discharge their duties cheaply, such as by outsourcing votes to ISS; activist funds and pension funds were driven by other incentives.[22] For that reason, Chief Justice Strine observed that giving shareholders additional power would exacerbate problematic power dynamics in corporate America (the next Sub-Section discusses these dynamics in further detail).

Later writing further developed this theme. By 2007, he had coined the phrase "separation of ownership from ownership," i.e., the practical reality that institutional investor intermediaries had different incentives from the "end-user investors."[23] He also signaled his concern that academic scholarship focused on one problem—the divergence of interests between corporate management and investors—at the exclusion of the other.[24] Given the growth of institutional investors and their sizeable role in corporate governance, this was a major omission. In addition, focusing exclusively on the agency problems that arise from managerial control of the corporation gave way to a specific set of recommendations: empower shareholders as a check on management misconduct. Nonetheless, as Chief Justice Strine explored in his response to Bebchuk and in later writing, when considering the problems created by the separation of ownership from ownership, shareholder empowerment was a double-edged sword. On the one hand, strengthening the rights and powers of shareholders would make management more accountable to shareholders; on the other, doing so would also benefit activist shareholders, who might not seek to use their power to benefit the company and its long-term shareholders. This theme culminated into a plea for corporate law academics to quit "fetishizing" the agency costs that flow from the separation of ownership and control, and instead focus on the agency costs that thwart institutional investor stewardship.[25]

And although it took some time, corporate law scholars have since delved into this subject area with fervor, developing theories and modelling

21. Leo E. Strine, Jr., *Toward a True Corporate Republic: A Traditionalist Response to Bebchuk's Solution for Improving Corporate America*, 119 HARV. L. REV. 1759, 1764 (2006) [hereinafter *Toward a True Corporate Republic*].

22. *Id.*

23. Strine, Jr., *supra* note 4, at 6–7.

24. *Id.*

25. *Id.* at 6.

the "agency costs of agency capitalism."[26] In this way, Chief Justice Strine's writing can be viewed as not only prescient, but also a catalyst for the focus of corporate law scholarship many years into the future.

B. Flawed Intermediaries

Chief Justice Strine's insights into the problem of separated ownership from ownership have shaped much of what came next. In particular, Chief Justice Strine pointed out several fault lines between the corporate governance dynamics wrought by institutional shareholders. One key problem mentioned above is that not all intermediaries have the incentive or ability to be active participants. In particular, mutual fund blockholders tend to be deferential to ISS and other profit-seeking proxy advisors and rarely proactive in governance.[27] This passivity allowed small activist investors, including hedge funds and public pension funds, to have outsized influence. The problem, Chief Justice Strine argued, is that these intermediaries do not necessarily represent the interests of the company and its other shareholders. In particular, activist hedge funds seek to generate "super-sized returns by putting pressure on public companies to change their managerial policies," generally seeking short-term results.[28] Indeed, given that activist hedge funds can exit before the risks from their preferred changes manifest (and in the meantime, can hedge to limit their exposure if their changes backfire), they have little incentive to push for action to benefit shareholders over the long term.[29] These critical observations catalyzed a rich debate between researchers on the effects of hedge fund activism.[30] They also brought about

26. *See, e.g.*, Gilson & Gordon, *supra* note 14; Bebchuk, Cohen & Hirst, *supra* note 16; Usha Rodrigues, *Corporate Governance in an Age of Separation of Ownership from Ownership*, 95 MINN. L. REV. 1822 (2011).

27. Indeed, long before many had focused on the limited incentives of index funds, Strine wrote: "Problematically, those institutional investors whose goals are most in line with ordinary Americans—those that manage index funds—have rational reasons to be as inert as possible when it comes to voting shares and influencing issuer behavior . . . . And many traditional money managers, such as mutual funds, would just as soon dispense with their votes altogether. They therefore look to proxy advisory firms, such as ISS and Glass Lewis, in order to give them a rational basis for explaining their voting decisions if questioned about their compliance with ERISA standards." Strine, Jr., *supra* note 4, at 16.

28. *Id.* at 5.

29. *Id.* at 7; Leo E. Strine, Jr., *Who Bleeds When the Wolves Bite?: A Flesh-and-Blood Perspective on Hedge Fund Activism and Our Strange Corporate Governance System*, 126 YALE L.J. 1870, 1950 (2017).

30. *Compare* Leo E. Strine, Jr., *One Fundamental Corporate Governance Question We Face: Can Corporations Be Managed for the Long Term Unless Their Powerful Electorates*

government attention to these issues.[31]

Beyond hedge fund activism, Chief Justice Strine's writing also focused on another group of active institutional investors: public pension funds. These investors, he observed, have a different set of concerns that may drive perverse outcomes for shareholders. Public pension funds are subject to political pressure, and indeed, may participate in governance to "justify their employment."[32] They may also seek outsized returns via some of the same strategies sought by activist hedge funds to cover "underfunding and past investment mistakes."[33]

What about mutual funds? As discussed, Chief Justice Strine's early work on institutional investors emphasized their passivity, their deference to proxy advisors who were likewise passive and conflicted, and their failure to consider the interests of their beneficial owners.[34] Importantly, however, Chief Justice Strine never gave up on the vision of these intermediaries as corporate governance saviors, especially given that mutual funds represented the holy grail in corporate governance—long term holders who bought shares and stayed the course. As such, the next chapter of Chief Justice Strine's writing and advocacy urged those intermediaries to take a full view of their duties and responsibilities to investors, as will be discussed in the next Section.

C. *Forced Capitalists*

In contrast to activist hedge funds, which Chief Justice Strine argued were likely to seek short-term returns at the expense of long-term value,

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Also Act and Think Long Term?, 66 BUS. L. 1 (2010), *and* JOHN C. COFFEE & DARIUS PALIA, THE WOLF AT THE DOOR: THE IMPACT OF HEDGE FUND ACTIVISM ON CORPORATE GOVERNANCE (2015), *and* Brian J. Bushee, Mary Ellen Carter & Joseph Gerakos, *Institutional Investor Preferences for Corporate Governance Mechanisms*, 26 J. MGMT. ACCT. RSCH., no. 2, 2013, at 123, *and* Kahan & Rock, *supra* note 15, at 1083, *and* Iman Anabtawi & Lynn A. Stout, *Fiduciary Duties for Activist Shareholders*, 60 STAN. L. REV. 1255, 1290–92 (2008), *with* Alon Brav et al., *Hedge Fund Activism, Corporate Governance, and Firm Performance*, 63 J. FIN. 1729, 1741–45 (2008). *See also* Alon Brav Wei Jiang & Hyunseob Kim, *Hedge Fund Activism: A Review*, 4 FOUNDS. & TRENDS FIN. 185, 221–30 (2009); Lucian A. Bebchuk Alon Brav & Wei Jiang, *The Long-Term Effects of Hedge Fund Activism*, 115 COLUM. L. REV. 1085 (2015).

31. *See, e.g.*, Press Release, The White House, Fact Sheet: The American Families Plan (Apr. 28, 2021), https://www.whitehouse.gov/briefing-room/statements-releases/2021/04/28/fact-sheet-the-american-families-plan/ [https://perma.cc/46MR-98K8] (asking Congress to close the carried interest loophole).

32. *See* Strine, Jr., *supra* note 4, at 6; *see also* Romano, *supra* note 13 (showing Strine was one of the first to highlight these incentive issues).

33. *See* Strine, Jr., *supra* note 4, at 5.

34. *See Id.*

mutual funds should be guided by different goals based on the very different composition of their investors. In light of changes in retirement policy, most ordinary working Americans have become "forced capitalists."[35] Unlike financial spectators, forced capitalists tended to invest their money in the stock market for the long term, with the goal of having enough funds "to send their children to college and provide for themselves in retirement."[36] Many of them are also employees and so they have no interest in "gimmicks that deliver quick bursts of cash at the expense of sustainable growth."[37] Likewise, forced capitalists are human beings with an interest in clean air and water, consumers of products who do not appreciate rising prices, and employees who depend on living wages, benefits, and a safe working environment.

The focus on the breadth of interests sought by American investors, which compose more than half of American households,[38] was also prescient. Today, scholars in law and finance alike emphasize that corporate management should focus on shareholder value or welfare, broadly construed.[39] Such ideas have permeated to the level of government, with the DOL recently clarifying that ESG factors should be taken into account by ERISA fiduciaries,[40] and the SEC working to mandate and standardize ESG disclosure requirements.[41] Not only that, investors are flocking to so-called "ESG" investment vehicles in record number, proving Chief Justice Strine's point that few are interested in wealth maximization at the exclusion of all

35. *See* Strine, Jr., *supra* note 4, at 4–5.

36. *See Id.* at 4.

37. *See Id.*

38. *See* Kim Parker & Richard Fry, *More Than Half of U.S. Households Have Some Investment in the Stock Market*, PEW RSCH. CTR. (Mar. 25, 2020), https://www.pewresearch.org/fact-tank/2020/03/25/more-than-half-of-u-s-households-have-some-investment-in-the-stock-market/ [https://perma.cc/J56V-SJCR].

39. *See* Oliver Hart & Luigi Zingales, *Companies Should Maximize Shareholder Welfare Not Market Value*, 2 J.L. FIN. & ACCT. 247 (2017) (arguing that companies should promote shareholder welfare, rather than market value).

40. *See* Mary Alcock, Michael Albano & Francesca Crooks, *New DOL Proposal on ESG Investing and Fiduciary Exercise of Shareholder Rights*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Nov. 9, 2021), https://corpgov.law.harvard.edu/2021/11/09/new-dol-proposal-on-esg-investing-and-fiduciary-exercise-of-shareholder-rights/ [https://perma.cc/UT7T-H7ZW].

41. *See* Gary Gensler, Chairman, SEC, Remarks before the European Parliament Committee on Economic and Monetary Affairs (Sept. 1, 2021), https://www.sec.gov/news/speech/gensler-remarks-european-parliament-090121 [https://perma.cc/S94C-SWQH] ("I have asked SEC staff to develop a proposal for climate risk disclosure requirements for the Commission's consideration.").

other interests.[42]

Moreover, Chief Justice Strine's genius in emphasizing the holistic consideration of investor welfare is that it meshed a stakeholder driven agenda with the traditional power structure of corporate law. And this reveals a hallmark of Chief Justice Strine's scholarship: a clear-eyed focus on what the law is, rather than what it should be.[43] Instead of arguing that fiduciaries had a legal obligation to pursue stakeholder welfare on the same footing as shareholders, Chief Justice Strine recognized the privileged place that shareholders are afforded under Delaware corporate law.[44] Of course, embedded in this seemingly narrow precept was a missed opportunity. As the investing class grew and expanded, so should the concept of fiduciary duty, as Chief Justice Strine demonstrated. This "enlightened shareholder value" lens has since taken off in the United States, and Chief Justice Strine's writing deserves much credit for this phenomenon.[45]

Chief Justice Strine's emphasis on the breadth of investor values in the modern capital market landscape reveals another important feature of his jurisprudence and scholarship—his ability to work within traditional corporate law frameworks and modernize them, to account for changed times and circumstances.[46] Not only that, it shows his willingness to eschew traditional economic doctrines when inconsistent with the incentives and

42. *See* Lizzy Gurdus, *ESG investing to reach $1 trillion by 2030, says head of iShares Americas as carbon transition funds launch*, CNBC (May 9, 2021, 10:00 AM), https://www.cnbc.com/2021/05/09/esg-investing-to-reach-1-trillion-by-2030-head-of-ishares-americas.html [https://perma.cc/RT7U-CX2S]. Chief Justice Strine prefers the term "EESG," giving employees privileged stature in the ESG conversation. Strine, Jr., *supra* note 5, at 8.

43. *See* Strine, Jr., *supra* note 9.

44. *See Id.*

45. *See* Lund & Pollman, *supra* note 10, at 2631.

46. His jurisprudence modernizing the *Caremark* doctrine provides another example. That doctrine imposes an oversight duty on corporate boards, but had long been a difficult claim to win. *See In re* Caremark Int'l Inc. Derivative Litig., 698 A.2d 959, 967 (Del. Ch. 1996) (setting forth the duty and then noting that it was "possibly the most difficult theory in corporation law upon which a plaintiff might hope to win a judgment"). And yet in several recent decisions, Chief Justice Strine found that plaintiffs had established enough facts to survive a motion to dismiss. *See* Marchand v. Barnhill, 212 A.3d 805 (Del. 2019). In these decisions, Chief Justice Strine focused on the severity of the directorial lapses, as well as the severity of the risk that the oversight failures presented to the company. *Id.* In scholarly writing, Chief Justice Strine (with co-authors) emphasized that ESG considerations were properly the subject of board attention pursuant to the *Caremark* doctrine, drawing on modern research that showed how a failure to take seriously ESG presented business risk. *See* Leo E. Strine, Jr., Kirby M. Smith & Reilly S. Steel, *Caremark and ESG, Perfect Together: A Practical Approach to Implementing an Integrated, Efficient, and Effective Caremark and EESG Strategy*, 106 IOWA L. REV. 1885 (2021).

preferences of the real people that they involve.[47]

D. Driving Alignment with Shareholder Values

And yet, despite increased recognition of these varied interests, Chief Justice Strine observed that many institutional investors continued to exercise their governance rights in pursuit of financial returns, at the expense of sustainable growth and community citizenship. For example, Strine pointed out that many institutions supported stock-buybacks and other financial maneuvers that have been linked to corporate short-termism.[48] Few aligned their voting policies with issues that were important to workers and society more broadly.[49] And once again, Chief Justice Strine's scholarship focusing on these deficiencies catalyzed important change.

Take corporate political spending as just one example. In *Fiduciary Blind Spot: The Failure of Institutional Investors to Prevent the Illegitimate Use of Working Americans' Savings for Corporate Political Spending*, Chief Justice Strine shone a spotlight on the puzzling reality that even as institutional investors improved in certain areas, such as by increasing pressure on companies to act ethically, they had adopted policies of total abdication and deference to management when it came to political spending. In particular, BlackRock stated in its 2019 proxy voting guidelines that it "believe[s] that it is not the role of shareholders to suggest or approve corporate political activities; therefore [it] generally do[es] not support proposals requesting a shareholder vote on political activities or expenditures."[50] Considered alongside Fink's lofty statements about the corporation's role in society and the importance of externality regulation,[51]

47. *See In re* Oracle Corp. Derivative Litig., 824 A.2d 917, 938 (Del. Ch. 2003) ("Delaware law should not be based on a reductionist view of human nature that simplifies human motivations on the lines of the least sophisticated notions of the law and economics movement. Homo sapiens is not merely homo economicus.").

48. *See* Strine, Jr., *supra* note 4, at 9; *see also* Leo E. Strine, Jr., *Securing Our Nation's Economic Future: A Sensible, Nonpartisan Agenda to Increase Long-Term Investment and Job Creation in the United States*, 71 BUS. LAW. 1081, 1082 (2016). *But see* Jesse M. Fried & Charles C.Y. Wang, *Are Buybacks Really Shortchanging Investment?*, HARV. BUS. REV., Mar.-Apr. 2018, at 88.

49. *Id.*

50. Leo E. Strine, Jr., *Fiduciary Blind Spot: The Failure of Institutional Investors to Prevent the Illegitimate Use of Working Americans' Savings for Corporate Political Spending*, 97 WASH. U. L. REV. 1007, 1019 (2020).

51. *See* Larry Fink, *Larry Fink's 2018 Letter to CEOs: A Sense of Purpose*, BLACKROCK (2018), https://www.blackrock.com/corporate/investor-relations/2018-larry-fink-ceo-letter/ [https://perma.cc/VM5X-D643]; *see also* Larry Fink, *Larry Fink's 2019 Letter to CEOs:*

this position was comically out of touch. Chief Justice Strine rightly pointed this out and observed that if the largest mutual fund complexes simply supported disclosure of corporate political spending, much would change.

In the year following the publication of Chief Justice Strine's article, BlackRock changed its policy to a much more nuanced one, acknowledging the risks that come from corporate political spending and stating that it "may support a shareholder proposal requesting additional disclosure."[52]

Likewise, in recent years, a greater number of institutional investors have supported shareholder proposals asking companies to disclose their corporate political spending.[53]

To take another example of Chief Justice Strine's influence over institutional investor policy, in a 2016 *Business Lawyer* Article, *Securing Our Nation's Economic Future: A Sensible, Nonpartisan Agenda to Increase Long-Term Investment and Job Creation in the United States*, Chief Justice Strine observed that most large mutual fund complexes were unduly influenced by outside proxy firms, and rarely exercised their shares in ways that would benefit the long-term interests of their beneficial owners.[54] He proposed that mutual funds "accepting 401(k) and college savings investments [should] have voting policies that take into account the long-term focus of their investors and their need for durable wealth creation."[55] He further argued that index funds should not rely on proxy advisory firms that lack fund-specific guidance.[56]

Again, Chief Justice Strine's writing helped to bring about improvements. Today, each of the Big Three mutual fund complexes eschew proxy advisor advice for the most important votes, instead developing voting

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Purpose & Profit, BLACKROCK (2019), https://www.blackrock.com/corporate/investor-relations/2019-larry-fink-ceo-letter [https://perma.cc/4EGF-9AC8]; Larry Fink, *Larry Fink's 2020 Letter to CEOs: A Fundamental Reshaping of Finance*, BLACKROCK (2020), https://www.blackrock.com/corporate/investor-relations/2020-larry-fink-ceo-letter [https://perma.cc/E93M-FMVX].

52. *See Commentary: BlackRock Investment Stewardship's perspective on corporate political activities*, BLACKROCK (Dec. 2020), https://www.blackrock.com/corporate/literature/publication/blk-commentary-perspective-on-corporate-political-activities.pdf [https://perma.cc/4UP6-AZX6].

53. *See* Ephrat Livni, *On Voting Rights: It Can Cost Companies to Take Both Sides*, N.Y. TIMES: DEALBOOK (2021), https://www.nytimes.com/2021/06/05/business/dealbook/voting-rights-companies.html [https://perma.cc/QQY8-HVBT] ("In 2019, there were 51 political spending proposals at S&P 500 companies; none passed, and they received an average of 28 percent support. Last year, of 55 similar proposals, six passed and average support rose to about 35 percent.").

54. *See* Strine, Jr., *supra* note 48.

55. *See Id.* at 20.

56. *See Id.*

guidelines and resolving issues in house.[57] They have each adopted specialized policies on environmental and social issues, and have driven real change by taking action to reduce greenhouse gas emissions and improve board diversity at their portfolio companies.[58] Some now allow portfolio managers greater leeway for to vote their investors' shares consistent with the investment thesis of the underlying fund,[59] and have announced that they will even give certain investors the option to cast their own votes.[60]

Ultimately, these examples reveal how Chief Justice Strine's scholarship highlighting the identity of mutual fund investors and their diverse interests has influenced mutual fund policy. And yet, Chief Justice Strine recognized that advocacy of this kind was unlikely to go as far as needed to address pressing global problems, which led him to propose regulatory reforms that will be the subject of the next Section.

II. SOLUTIONS

Chief Justice Strine's scholarship has gone well beyond pointing out flaws in the contemporary corporate governance landscape; indeed, his articles and speeches contain rich sets of policy proposals, many of which have been adopted into law or are being seriously considered today. Rather than summarize them all, this Section first addresses the limits of some of his ambitious policy proposals involving mutual funds, and second, highlights some of his sensible proposals to recalibrate our corporate governance system and its imbalance in favor of institutional shareholders.

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57. *See, e.g.*, *Proxy Voting and Shareholder Engagement FAQ*, BLACKROCK, https://www.blackrock.com/corporate/literature/fact-sheet/blk-responsible-investment-faq-global.pdf [https://perma.cc/KPG5-ZM7E] (last visited Jan. 24, 2022) (observing that BlackRock's investment stewardship team performs independent research and analysis: "coming to vote conclusions that are consistent with our own voting guidelines and that we believe are in the best long-term economic interests of our clients. The team does not follow the recommendations of any single proxy advisor. While we subscribe to research from several proxy advisory firms, their research is one among many inputs into our vote analysis process").

58. *See* Dorothy Lund, *Asset Managers as Regulators*, 171 U. PA. L. REV. (forthcoming 2022), https://dx.doi.org/10.2139/ssrn.3975847.

59. *See* Hortense Bioy et al., *Passive Fund Providers Take an Active Approach to Investment Stewardship*, MORNINGSTAR (Dec. 2017), https://www.morningstar.com/content/dam/marketing/shared/pdfs/Research/Morningstar-Passive-Active-Stewardship.pdf [https://perma.cc/X7QD-B7DV].

60. *See* Dawn Lim, *BlackRock Gives Big Investors Ability to Vote on Shareholder Proposals*, WALL ST. J. (Oct. 7, 2021, 1:21 PM), https://www.wsj.com/articles/blackrock-gives-big-investors-ability-to-vote-on-shareholder-proposals-11633617321 [https://perma.cc/YLG8-MSGP].

A. Mutual Fund and Index Fund Stewardship

As the previous Section revealed, Chief Justice Strine's scholarly work has identified mutual funds, and index funds in particular, as "the most rational investors."[61] This is because of index funds' relatively long investment horizon—years, rather than days—as well as the composition of their underlying investors—ordinary people who "patiently save for retirement," and who hold a diversified portfolio consisting of the market as a whole.[62] Starting from those first principles, Chief Justice Strine has highlighted the lack of the independent thinking exhibited by mutual fund complexes and their unprincipled voting and engagement policies.[63] He has further proposed reforms designed to make mutual funds better stewards of portfolio companies, such as by requiring them to invest greater resources in stewardship and perform their own independent research.[64]

Embedded in these policy proposals are two assumptions: first, that investors in index funds would be better off if their intermediaries invested greater resources in stewardship and research; and second, that our corporate governance system as a whole would work better if mutual funds exercised their voice more thoughtfully. Another view is possible, however, that might point toward different solutions: that index funds, despite their buy and hold investment strategy, are not likely to be corporate governance saviors. Moreover, investors and society may be worse off if we ask them to fight their incentives and invest substantial sums in stewardship.

Chief Justice Strine is right to lament the stewardship practices of index fund providers, which are a byproduct of their low-cost passive investing strategy. As a result of their business models, the main providers of index funds rarely initiate interventions at portfolio companies, nor do they invest in the firm-specific information necessary to exercise governance rights

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61. Strine, Jr., *supra* note 48, at 1092.

62. *Id.*

63. *Id.*

64. Strine, Jr., *supra* note 6, at 25 ("Requiring a certain level of stewardship by all institutional investors: My friends Professors Bebchuk and Lund are not wrong that the leading index funds do not have enough stewardship resources to adequately consider all the votes that occur. That is why fewer, more meaningful, votes should occur. But another problem must be addressed: the big index funds do way better than most. If we are going to encourage institutions to vote, then all of them must be expected to invest in stewardship, so that perverse pricing pressures do not inhibit stewardship. Absent a return to the Wall Street rule, an industry-wide expectation of stewardship is essential, so that those trying to do things right are not undercut by free-riders and the benefits of greater alignment are lost.").

sensibly across their broad portfolios.[65] The most we can hope for, therefore, under the existing state of affairs, is that the corporate governance groups at these largely indexed institutions will be able to support the right active investors, and that they will adhere to one-size-fits-all voting policies that will benefit their investors on average.[66]

Assuming they are able to do this, this existing balance of power does not appear especially problematic. As Jeffrey Gordon and Ronald Gilson have described, a corporate governance system in which certain active investors initiate proposals for mutual fund giants to approve or veto may be close to optimal.[67] In other words, we may not need every investor to invest in firm-specific information and stewardship so long as we have a threshold number of active investors, and those relatively passive investors know when to support them.

There are reasons to be skeptical that passive funds, which again, lack firm-specific information, will reliably do this. Even so, asking index funds to invest greater resources in stewardship has its own costs, and in particular, increasing the costs that investors pay.[68] Index funds offer bottom-of-the-barrel fees because they eschew research and other costs associated with stock-picking.[69] If they were to truly improve their research and stewardship efforts across their broad portfolios, which consist of thousands of companies across the globe, the attenuating costs would hit ordinary investors hard.[70] Moreover, asking index funds to beef up their participation would also preserve what has become a troubling corporate governance dynamic in its own right—an extreme concentration of power in the hands

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65. Lucian Bebchuk & Scott Hirst, *Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy*, 119 COLUM. L. REV. 2029 (2019); Lund, *supra* note 58; Marcel Kahan & Edward B. Rock, *Index Funds and Corporate Governance: Let Shareholders Be Shareholders*, 100 B.U. L. REV. 1771 (2020). Chief Justice Strine himself has noted how the largest fund complexes centralize their governance and generally exercise all of their votes in the same direction, regardless of the fund's thesis.

66. Jeffrey N. Gordon, *Systematic Stewardship*, J. Corp. L. (forthcoming 2022), https://dx.doi.org/10.2139/ssrn.3782814; Kahan & Rock, *supra* note 65.

67. Gilson & Gordon, *supra* note 14.

68. Lund, *supra* note 58; M. Todd Henderson & Dorothy Shapiro Lund, Opinion, *Index Funds Are Great for Investors, Risky for Corporate Governance*, WALL ST. J. (June 22, 2017, 06:30 PM), https://www.wsj.com/articles/index-funds-are-great-for-investors-risky-for-corporate-governance-1498170623 [https://perma.cc/59BD-W4HF].

69. *Id.*

70. *See* Jill Fisch, *The Uncertain Stewardship Potential of Index Funds*, *in* GLOBAL SHAREHOLDER STEWARDSHIP: COMPLEXITIES, CHALLENGES AND POSSIBILITIES 454 (Dionysia Katelouzou & Dan W. Puchniak eds., 2022) (discussing the costs that accompany proposals to increase index fund participation in governance).

of a small number of asset managers.[71]

This concentration of power in the hands of largely indexed institutions is likely to continue to grow, however, which may necessitate more drastic legislative interventions. And if and when passive funds begin crowding out other investors, my research suggests that the better direction would be to limit the influence of these powerful but flawed intermediaries in corporate governance,[72] rather that make them incur costs to fight their incentives, costs that would ultimately fall on the ordinary investors that Chief Justice Strine has worked so hard to protect. BlackRock's decision to pass through votes to investors that would like to exercise them is a step in the right direction[73]—it ameliorates both the problem of passive, uninformed blockholders dictating voting outcomes, as well as Chief Justice Strine's concern that votes will be exercised by intermediaries in ways that are counter to their interests.

In sum, I am doubtful that reforms mandating improved index fund stewardship will necessarily benefit investors or the corporate governance ecosystem. But there is another concern motivating Chief Justice Strine's proposals: the reality of persistent inequality in the United States that has left workers and other stakeholders in the dust. Specifically, over time, as the power of institutional shareholders grew enormously, protections for workers and other stakeholders decreased.[74] Relatedly, the growing acceptance of a shareholder wealth maximization framework ensured that corporate surplus accrued to investors and corporate management who were increasingly compensated in stock, rather than the employees whose labor contributed to the surplus.[75] To quote my esteemed mentor: "This is not about the pie not growing. There has been plenty o' new pie. It is about the have's taking a much bigger share of the pie."[76] Perhaps, therefore, if mutual funds were bound to consider the ways in which shareholder-centric policies hurt their investors, corporate governance would contribute to less

71. John C. Coates, *The Future of Corporate Governance Part I: The Problem of Twelve* (Harv. Pub. L. Working Paper, Working Paper No. 19-07, 2018), https://dx.doi.org/10.2139/ssrn.3247337; Lund, *supra* note 58.

72. Lund, *supra* note 58; Dorothy S. Lund, *Nonvoting Shares and Efficient Corporate Governance*, 71 STAN. L. REV. 687, (2019); John Rekenthaler, *3 Solutions for Index-Fund Voting*, MORNINGSTAR (Jun. 14, 2021), https://www.morningstar.com/articles/1042975/3-solutions-for-index-fund-voting [https://perma.cc/6L3B-MAHQ].

73. Lim, *supra* note 60; *see also* Fisch, *supra* note 70 (considering the benefits of using pass-through voting to enhance the stewardship potential of index funds).

74. Strine, Jr., *supra* note 6; Strine, Jr., *supra* note 5.

75. Strine, Jr., *supra* note 6; Strine, Jr., *supra* note 5; *see also* Zohar Goshen & Doran Levit, *Common Ownership and the Decline of the American Worker* (Colum. L. & Econ., Working Paper, Paper No. 653, 2021), https://dx.doi.org/10.2139/ssrn.3832069.

76. Strine, Jr., *supra* note 6, at 18.

inequality.

Although I support advocacy by Chief Justice Strine and others[77] arguing that the managers of diversified investment portfolios are duty-bound to consider environmental and social goals, I am ultimately skeptical that mutual fund interventions will take us as far as society needs to go in addressing these important issues. At the end of the day, mutual funds and their portfolio managers are evaluated based on their portfolio's relative performance (and compensated based on the value of the portfolio), which means that they will generally favor management decisions that create shareholder wealth, at the expense of workers and society. Not only that, such reforms do nothing to disrupt the existing balance of power, where powerful institutional shareholders act like regulators by setting priorities for companies and determining how to respond to pressing global problems.[78] For those reasons, I believe that the best course of action to address this source of inequality is to adopt reforms that would empower stakeholders as a counterweight to institutional investor power. Chief Justice Strine has developed many important policy prescriptions that would do just this, which is the topic of my next Section.

B. Improving Protections for Stakeholders to Counterbalance the Rise of institutional Investor Power

Much of Chief Justice Strine's advocacy and legislative proposals address the problem of inequality in the U.S. In particular, Chief Justice Strine has proposed many thoughtful and sensible reforms that would improve the voice of workers and communities in relation to institutional shareholders.

Regarding workers, Chief Justice Strine has proposed that companies be required to implement a system of European works councils that would address employee issues at the board level.[79] Such a proposal, if implemented, would force corporate management to take seriously worker concerns and issues, and more fairly allocate their corporate surplus.[80] In

77. *See also* Madison Condon, *Externalities and the Common Owner*, 95 WASH. L. REV. 1, (2020); Gordon, *supra* note 66; Stavros Gadinis & Amelia Miazad, *Corporate Law and Social Risk*, 73 VAND. L. REV. 1401 (2020).

78. Lund, *supra* note 58; Coates, *supra* note 71.

79. Strine, Jr., *supra* note 5, at 9; *see also* Leo E. Strine, Jr., Aneil Kovvali & Oluwatomi O. Williams, *Lifting Labor's Voice: A Principled Path Toward Greater Worker Voice and Power Within American Corporate Governance*, 106 MINN. L. REV. 1325 (2022).

80. See Simon Jäger, Shakked Noy & Benjamin Schoefer, *What Does Codetermination Do?* (Nat'l Bureau of Econ. Rsch., Working Paper No 28921, 2021), https:// www.nber.org

addition, Chief Justice Strine has focused on the benefit corporation as an important vehicle for change. Benefit corporations require management to consider, as a matter of fiduciary duty, the interests of stakeholders, in addition to shareholders.[81] Although nearly every state has benefit corporation legislation, few large public companies have converted.[82] This may be because of obstacles in the way; accordingly, Chief Justice Strine has argued that states should take action to reduce impediments to becoming a benefit corporation.[83] Chief Justice Strine has also proposed that companies accepting bailout money should be required to adopt benefit corporation status—a sensible obligation for companies who are given millions and even billions of dollars of taxpayer money, and one that would increase momentum for benefit corporations among large public companies.[84]

In addition, Chief Justice Strine has rightly focused on the dynamics that contribute to the weakening of worker rights and community protections, and the changed legal environment surrounding corporate political spending in particular. It is obvious by now that unrestricted corporate political spending contributes to a political process that privileges corporate interests at the expense of workers and other groups. As a result, the legislative process is likely to continue to adopt rules that skew in favor of corporations, their management, and their shareholders, until the dynamics that compromise the political environment change. For these reasons, Chief Justice Strine has offered many sensible proposals, including that public companies be prohibited from spending money on politics without a supermajority shareholder vote.[85] Again, assuming shareholders have values that extend beyond mere profit, such a requirement would keep companies from making expenditures contrary to shareholder value as it is

/papers/w28921 [https://perma.cc/UHS4-ECUL] (surveying the evidence that certain mechanisms to involve workers in governance lead to wage increases and within-firm equality).

81. Strine, Jr., *supra* note 5, at 5.

82. See *Publicly Traded B Corps*, B IMPACT ASSESSMENT (July 6, 2021, 11:06 AM), https://kb.bimpactassessment.net/en/support/solutions/articles/43000632643-publicly-traded-b-corps (noting there are only 4 publicly traded B Corps in the United States).

83. Delaware followed one of his suggestions last year when it amended Section 363 of the Delaware General Corporate Law to reduce the necessary conversion vote from a supermajority of shareholders to a simple majority. Elizabeth K. Lange & Elizabeth A. Diffley, *New Amendments to Delaware General Corporation Law Will Make It Easier for Companies to Become Public Benefit Corporations*, FAEGRE DRINKER LLP (July 22, 2021), https://www.faegredrinker.com/en/insights/publications/2020/7/new-amendments-to-delaware-general-corporation-law-will-make-it-easier-for-companies-to-become-publi [https://perma.cc/9J54-F8K5].

84. Strine, Jr., *supra* note 5, at 13.

85. *Id.*

more broadly conceived. In addition, disclosure would likely chill the most egregious political spending practices.

Although I lack the space to highlight all of Chief Justice Strine's good ideas, these examples demonstrate his willingness to work tirelessly to address deep and pressing problems, and to create a system of governance that works for everyone.

III. CONCLUSION

In addition to being widely recognized as one of the most influential corporate law judges of the past half century, Chief Justice Strine is also a prolific corporate law scholar. This essay focused on one aspect of his scholarly writing: his focus on institutional shareholders, their limitations, and their potential to bring about a better corporate governance system and world. It suggested some limits to his advocacy arguing that diversified mutual fund blockholders can bring about these changes themselves, and focused on some of his best ideas that would empower other stakeholders to counterbalance shareholder power. In so doing, it highlighted the aspects of his writing that have contributed to his lasting impact: his clear-eyed view of the law and its limits, his ability to modernize stale legal and economic frameworks, and his desire to make the world a better place for the ordinary people who live in it.